100th Congress
2d Session

HOUSE OF REPRESENTATIVES

Report
100–1104

TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988

CONFERENCE REPORT

TO ACCOMPANY

H.R. 4333

Volume II of 2 Volumes

October 21, 1988.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
89–860 WASHINGTON : 1988

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, DC 20402

H783-12

CONTENTS OF STATEMENT OF MANAGERS

Page

Technical Corrections Provisions 1
- I. Technical Corrections to the Tax Reform Act of 1986 1
- II. Technical Corrections to Other Tax Legislation 15

Substantive Revenue Provisions 20
- I. Diesel Fuel Excise Tax Collection and Exemption Procedures (Sec. 310 of the House bill and Secs 301–303 of the Senate amendment) 20
- II. Additional Simplification and Clarification Provisions 23
  - A. Sanction for Violation of the Health Care Continuation Rules (Sec. 321 of the House bill and Sec. 421 of the Senate amendment) 23
  - B. Nondiscrimination Rules for Statutory Employee Benefit Plans (Sec. 322 of the House bill and Sec. 422 of the Senate amendment) 27
  - C. Estate and Gift Tax: Estate Freezes (Sec. 204(s) of the House bill and Sec. 423 of the Senate amendment) 71
  - D. Tax Treatment of Indian Fishing Rights (Secs. 401–404 of the Senate amendment) (H.R. 2792 passed by the House) 77
- III. Extensions and Modifications of Expiring Tax Provisions 78
  - A. Extension of Exclusion for Employer-Provided Educational Assistance (Sec. 301 of the House bill and Sec. 788 of the Senate amendment) 78
  - B. Extension of Exclusion for Employer-Provided Group Legal Services (Sec. 789 of the Senate amendment) 80
  - C. Low-Income Rental Housing Tax Credit 81
    - 1. Extension of low-income rental housing tax credit (sec. 302 of the House bill) 81
    - 2. Modifications to the low-income rental housing tax credit (secs. 368–369 of the House bill and sec. 786 of the Senate amendment) 81
  - D. Extension and Modification of Qualified Mortgage Bonds and Mortgage Credit Certificates (Sec. 303 of the House bill and secs. 737, 739, and 787 of the Senate amendment) 83
  - E. Extension of Special Student Loan Bond Arbitrage Rules (Sec. 790 of the Senate amendment) 85
  - F. Extension of Business Energy Tax Credits for Solar, Geothermal, and Ocean Thermal Property (Sec. 791 of the Senate amendment) 86
  - G. Research and Development Provisions 87

Page

1. Extension of research tax credit (sec. 305 of the House bill and sec. 793 of the Senate amendment) 87
2. Denial of deduction for amounts allowed as a research credit (sec. 306 of the House bill) 88
3. Allocation and apportionment of R&D expenses (sec. 307 of the House bill and sec. 796 of the Senate amendment) 89

H. Extension of Targeted Jobs Tax Credit (Sec. 308 of the House bill and Sec. 792 of the Senate amendment) 90
I. Treatment of Mutual Fund Shareholder Expenses for Purposes of the 2-Percent Floor on Miscellaneous Itemized Deductions (Sec. 309 of the House bill) 91
J. Financially-Troubled Financial Institutions: Reorganizations, NOLs, and FSLIC/FDIC Assistance Payments (Sec. 794 of the Senate amendment) 92

IV, Revenue-Increase Provisions 95
- A. Corporate Estimated Tax Payments (sec. 314 of the House bill and sec. 700 of the Senate amendment) 95
- B. Life Insurance Provisions 96
  1. Treatment of single premium and other investment-oriented life insurance contracts (secs. 313 and 348 of the House bill and sec. 701 of the Senate amendment) 96
  2. Limitation on unreasonable mortality and expense charges for purposes of the definition of life insurance (sec. 346 of the House bill) 106
  3. Valuation of group term life insurance (sec. 347 of the House bill and sec. 1010(c) of the Senate amendment) 109
- C. Loss Transfer Rules for Alaska Native Corporations (sec. 315 of the House bill and sec. 702 of the Senate amendment) 109
- D. Update IRS Valuation Tables (sec. 371 of the House bill and sec. 704 of the Senate amendment 112
- E. Estate Tax Provisions 113
  1. Disallow marital deduction where spouse is not a citizen of the United States (sec. 372 of the House bill and sec. 441(b) of the Senate amendment) 113
  2. Repeal special rates and credits for foreign estates (sec. 373 of the House bill and sec. 1009 of the Senate amendment) 115
- F. Completed Contract Method of Accounting for Long-Term Contracts (sec. 312 of the House bill). 116
- G. Reduction in Dividends Received Deduction for Portfolio Stock (sec. 311 of the House bill) 120
- H. Tax-Exempt Bonds 121

Page

        1. Restrictions on issuance of pooled financing bonds (sec. 304 of the House bill) 121
        2. Student loan bonds 124
            a. Reduction in permitted purpose arbitrage on loans financed with tax-exempt student loan bonds (sec. 366 (a) and (b) of the House bill) 124
            b. Loan origination and bond redemption requirements for student loan bonds (sec. 366(c) of the House bill) 125
        3. Restrictions on bonds used to provide residential rental housing (sec. 367 of the House bill and sec. 1005 of the Senate amendment) 125
    I. Excise Tax Provisions 127
        1. Excise tax on pipe tobacco (sec. 380 of the House bill) 127
    J. Other Revenue-Increase Provisions 128
        1. Increase in penalty for bad checks (sec. 382 of the House bill) 128
        2. Pension reversions of qualified plan assets: temporary increase in excise tax (sec. 799 of the Senate amendment) 128
        3. Denial of deduction for certain residential telephone service (sec. 337 of the House bill) 129
        4. Information reporting by partnerships with tax-exempt partners (sec. 1008 of the Senate amendment) 130
        5. Application of wash sale rules to options (sec. 1010(b) of the Senate amendment) 131
        6. Treatment of certain installment sales by nondealers 132
V. Other Substantive Revenue Provisions 133
    A. Individual Provisions 133
        1. Treatment of certain payments to colleges for right to purchase athletic tickets (sec. 331 of the House bill and sec. 728 of the Senate amendment) 133
        2. Nonrecognition of gain on sale of old residence where one spouse dies before occupying new residence (sec. 333 of the House bill) 134
        3. Full deductibility of meals provided to employees on certain vessels or drilling rigs (sec. 334 of the House bill) 134
        4. Treatment of certain innocent spouses (sec. 335 of the House bill) 135
        5. Interim treatment of certain amounts awarded to Christa McAuliffe Fellows (sec. 336 of the House bill) 136
        6. Election by parent to claim unearned income of certain children on parent's return (sec. 733 of the Senate amendment) 137

Page

7. Above-the-line deduction for jury pay that employee must surrender to employer (sec. 755 of the Senate amendment) 138
8. Medical expense deduction for costs of service animals to assist handicapped individuals (Senate amendment, Committee Report) 138
9. Medical expense deduction for certain radon mitigation costs (sec. 800G of the Senate amendment) 139
10. Education savings bonds and modification of student dependency exemption 140
    a. Education savings bonds (secs. 431-433 of the Senate amendment) 140
    b. Dependency exemption for certain students (sec. 434 of the Senate amendment) 142
    c. State prepaid tuition plans (sec. 1012 of the Senate amendment) 143
11. Exclusion of gain on sale of principal residence by certain incapacitated taxpayers age 55 or over (sec. 1010(a) of the Senate amendment) 143
12. Business use of automobiles by rural letter carriers (sec. 332 of the House bill and sec. 760 of the Senate amendment) 144

B. Accounting/Agriculture Provisions 145
1. Repeal uniform capitalization rules for freelance authors, photographers, and artists (sec. 338(a) of the House bill and sec. 795(a) of the Senate amendment) 145
2. Repeal uniform capitalization rules for certain producers of animals; depreciation of certain farm property 146
    a. Uniform capitalization rules for certain producers of animals (sec. 338(b) of the House bill and sec. 795(b) of the Senate amendment) 146
    b. Treatment of single-purpose agricultural or horticultural structures (sec. 339 of the House bill and sec. 795(c) of the Senate amendment) 147
    c. Treatment of property used in a farming business (sec. 340 of the House bill and sec. 795(d) of the Senate amendment) 147
3. Election of producers of pistachio nuts to deduct preproductive period costs currently (sec. 338(c) of the House bill and sec. 800D of the Senate amendment) 148
4. Treatment of certain trees and vines (sec. 800M of the Senate amendment) 149
5. Treatment of livestock sold on account of drought (sec. 708 of the Senate amendment). 150

Page

6. Treatment of certain payments received as a result of crop losses due to drought conditions (sec. 411(a) of the Senate amendment).. 150
7. Treatment of certain pledged installment obligations (sec. 341 of the House bill and sec. 753 of the Senate amendment)........................ 151
8. Treatment of stock held in trust in determining whether certain corporations may use the cash method of accounting (sec. 342 of the House bill and sec. 754 of the Senate amendment).. 152

C. Pension and Employee Benefit Provisions.............. 153
1. Employee benefit nondiscrimination rules for church plans and cafeteria plans (sec. 710 of the Senate amendment)........................ 153
2. Eligible deferred compensation plans: Modifications to section 457 (sec. 350 of the House bill and sec. 111(e)(11) of the Senate amendment).. 153
3. Section 403(b) nondiscrimination rules and certain other pension requirements (sec. 352(a) of the House bill and sec. 711 of the Senate amendment).. 155
4. Required beginning date for public employees (sec. 352(b) of the House bill and sec. 720 of the Senate amendment)................................ 156
5. Limitations on contributions and benefits under qualified plans maintained by public employers (sec. 352(c) of the House bill and sec. 716 of the Senate amendment)................ 157
6. Minimum participation rule (sec. 352(d) of the House bill and secs. 712 and 718 of the Senate amendment).. 157
7. Permit IRA acquisitions of State-issued coins (sec. 719 of the Senate amendment)................ 158
8. Application of pension funding rules to multiple employer plans (sec. 721 of the Senate amendment).. 159
9. Application of section 415 plan limits for police and firefighters (sec. 800J of the Senate amendment).. 160
10. Employee leasing safe harbor rule (sec. 715 of the Senate amendment)................................ 161
11. Air transportation of cargo and passengers treated as same service for purpose of fringe benefit inclusion (sec. 353 of the House bill).. 161
12. Excise tax on disposition of stock by an ESOP not to apply to certain involuntary dispositions (sec. 354 of the House bill and sec. 800E of the Senate amendment)............. 162
13. Exclusion of interest refinanced ESOP loans (sec. 800 of the Senate amendment)................ 162

Page
14. Nondiscrimination rules for cafeteria plans (sec. 800B of the Senate amendment) 163
15. Cash or deferred arrangements of railroad employees (sec. 800P of the Senate amendment) 163
16. Application of sec. 415 limits to collectively bargained plans (sec. 800W of the Senate amendment) 164
17. Application of sec. 89 nondiscrimination rules to small employers (sec. 800X of the Senate amendment) 165
18. Allocation of assets in case of plan spinoffs (sec. 800Z of the Senate amendment) 166
19. Section 401(k) plans available to rural telephone cooperatives (sec. 351 of the House bill and sec. 714 of the Senate amendment) 166
20. Study of tax treatment of certain technical services personnel (sec. 355 of the House bill and sec. 722 of the Senate amendment) 167
21. Taxation of pension distributions to former spouses 168
D. Insurance Provisions 169
1. Church self-insured death benefit plans treated as life insurance (sec. 343 of the House bill and sec. 717 of the Senate amendment) 169
2. Minimum tax treatment of structured settlement arrangements (sec. 344(a) of the House bill and sec. 756 of the Senate amendment) 170
3. Repeal of general creditor requirement for certain personal injury liability assignments (sec. 344(b) of the House bill and sec. 757 of the Senate amendment) 170
4. Treatment of certain workers' compensation funds (sec. 345 of the House bill) 171
5. Prepaid tax certificates (sec. 349 of the the House bill) 172
6. Phase-in of property and casualty insurance company discounting rules for certain hospital insurers (sec. 758 of the Senate amendment) 175
7. Diversification requirements for variable annuity and life insurance contracts (sec. 800*O* of the Senate amendment) 176
E. Excise Tax Provisions 176
1. Certain tolerances permitted in determination of wine excise tax (sec. 374 of the House bill and sec. 730 of the Senate amendment) 176
2. Gasoline wholesalers permitted to claim refunds on behalf of certain exempt users (sec. 375 of the House bill and sec. 731 of the Senate amendment) 177

Page
3. Exemption from truck excise tax where benefit accrues to the United States (sec. 376 of the House bill and sec. 800H of the Senate amendment) 177
4. Certain repairs not treated as manufacturing for the retail excise tax on trucks (sec. 729 of the Senate amendment) 178
5. Reduced gasoline excise tax rate for gasohol blenders (sec. 800A of the Senate amendment) 179
6. Application of annual distilled spirits occupational tax 179
    a. Exemption for certain educational organizations receiving distilled spirits tax-free for research purposes (sec. 727 of the Senate amendment) 179
    b. Exemption for certain small plants producing exclusively for fuel uses (sec. 752 of the Senate amendment) 180
7. Allow quarterly payment of excise tax on bows and arrows (sec. 379 of the House bill). 180
8. Commencement date of Oil Spill Liability Trust Fund and excise tax on petroleum (sec. 384 of the House bill) 181
9. Harbor maintenance tax 181
    a. Exemption from harbor maintenance tax for cargo donated overseas for humanitarian purposes (sec. 377 of the House bill and sec. 726 of the Senate amendment) 181
    b. Harbor maintenance tax to be imposed once on certain Alaska, Hawaii, or possessions cargo (sec. 800Y of the Senate amendment) 182
10. Study of cigarette excise tax and effects of smoking on health care costs; economic impact of tobacco excise taxes (sec. 378 of the House bill and sec. 736 of the Senate amendment) 183
F. Foreign Provisions 184
1. Dual resident companies (sec. 356 of the House bill and sec. 745 of the Senate amendment) 184
2. Election to treat passive foreign investment company (PFIC) stock as stock in a qualified electing fund (sec. 357 of the House bill and sec. 732 of the Senate amendment) 185
3. Debt-equity ratio of Netherlands Antilles finance subsidiaries (sec. 359 of the House bill and sec. 800L of the Senate amendment) 185
4. Treatment of certain insurance branches of controlled foreign corporations (sec. 361 of the House bill and sec. 748 of the Senate amendment) 186

Page
5. Foreign currency transactions (sec. 358 of the House bill and sec. 744 of the Senate amendment) 187
6. Chain deficit rule for controlled foreign corporations (sec. 746 of the Senate amendment) 195
7. Qualified possession source investment income (sec. 747 of the Senate amendment) .. 195
8. Banks organized in possessions (sec. 749 of the Senate amendment) 196
9. Gambling winnings of nonresident aliens (sec. 360 of the House bill) 196
10. Controlled foreign insurance corporations owned by U.S. persons (sec. 797 of the Senate amendment) 197
11. Tax exemption for Enjebi Community Trust Fund (sec. 383 of the House bill) 198
12. Cost-of-living allowances for judicial branch employees outside the United States (sec. 759 of the Senate amendment) 198
13. Dividends paid by U.S. corporations (sec. 112(g)(1)(b) of the Senate amendment) 199
14. Study on the definition of a resident alien (sec. 800N of the Senate amendment) 199
15. Bermuda and Barbados income tax treaties (sec. 1013 of the Senate amendment) 200
16. Treatment of certain awards by the District Court of Guam 200

G. Estate Tax Provisions 201
1. Special use valuation of farm property for estate tax purposes (sec. 370 of the House bill and sec. 706 of the Senate amendment) .. 201
2. Treatment of joint and survivor annuities under QTIP rules (sec. 323 of the House bill and sec. 713 of the Senate amendment) 202

H. Tax-Exempt Bonds 202
1. Clarification of definition of manufacturing for qualified small-issue bonds (sec. 362 of the House bill) 202
2. Extension of minimum period for calculating TRAN safe-harbor compliance (sec. 363 of the House bill) 203
3. Application of the security interest test to bond financing of hazardous waste clean-up funds (sec. 738 of the Senate amendment) 204
4. Tax-exempt financing for certain high-speed rail facilities (sec. 740 of the Senate amendment) 204
5. Clarification of Treasury Department arbitrage rebate regulatory authority with respect to governmental bonds (sec. 363(b) of the House bill) 205

Page
6. Application of arbitrage rebate requirement to *bona fide* debt service funds (sec. 364 of the House bill and sec. 741 of the Senate amendment) 206
7. Certain volunteer fire departments to qualify for tax-exempt financing (sec. 365 of the House bill) 207
8. Disregard of pooled financings in determination of qualification for small-issuer exception (sec. 113(a)(45) of the Senate amendment) 207
I. Exempt Organizations 208
1. Effective date for UBIT treatment of income from certain games of chance (sec. 724 of the Senate amendment) 208
2. Purchasing of insurance by tax-exempt hospital service organizations (sec. 725 of the Senate amendment) 209
3. Determination of operating foundation status for certain purposes (sec. 387 of the House bill) 209
4. Treatment of exempt organization expenditures to influence the nomination or appointment of individuals to nonelective public office (sec. 1004 of the Senate amendment) 210
5. Discharge of indebtedness income of rural mutual or cooperative utility companies (sec. 386 of the House bill and sec. 707 of the Senate amendment) 211
J. Taxpayer Bill of Rights (secs. 763-785 of the Senate Amendment) 211
K. Other Administrative Provisions 234
1. Tip reporting (House bill, Committee Report) 234
2. Disclosure of return information to certain cities (sec. 381 of the House bill and sec. 735 of the Senate amendment) 235
3. Provisions relating to previously-required studies (sec. 393 of the House bill) 236
4. Treasury authority to prescribe class lives (sec. 798 of the Senate amendment) 236
5. Repeal of reporting requirements for windfall profit tax (sec. 207 of the Senate amendment) 237
L. Corporate/Personal Holding Company Provisions . 237
1. Authority to pay refunds to fiduciary of insolvent members of affiliated groups (sec. 385 of the House bill) 237
2. Certain ownership changes not counted during bankruptcy (sec. 741 of the Senate amendment) 238
3. Application of Code sec. 7503 for purposes of *Woods Investment Co.* effective date (sec. 388 of the House bill) 239

Page
4. Application of rules on personal holding company income to broker-dealers (sec. 743 of the Senate amendment) 239
5. Elimination of dividends received from banks from personal holding company income of bank holding companies (sec. 392 of the House bill) 240
6. Substantiation of certain charitable contributions of inventory property by corporations (sec. 800C of the Senate amendment 240
7. Relief from recognition of corporate level gain involving transfer of residential cooperative units (sec. 800I of the Senate amendment) 241
8. Definition of ESOP eligible for relief from net operating loss limitation 242
M. Miscellaneous Provisions 243
1. Repeal of limitation on Treasury long-term bond authority (sec. 389 of the House bill and sec. 411 of the Senate amendment) 243
2. Bad debt reserve exception for small banks (sec. 742 of the Senate amendment) 243
3. One-year extension of placed-in-service rule for nonconventional fuels tax credit (sec. 390 of the House bill and sec. 751 of the Senate amendment) 244
4. Carryover of nonconventional fuels tax credit under the minimum tax (sec. 750 of the Senate amendment) 245
5. Certain discharge of debt income not included in adjusted book income (sec. 391 of the House bill) 245
6. Treatment of certain corporations that are engaged in the sale of residential lots or timeshares for purposes of the alternative minimum tax (sec. 1007 of the Senate amendment) 246
7. Deductibility of adoption expenses (sec. 1006 of the Senate amendment) 246
8. Status of certain dependent care providers (sec. 1011 of the Senate amendment) 247
VI. Railroad Unemployment and Retirement Provisions 250
A. Railroad Unemployment Amendments (secs. 501–502, 511–514, 516, and 521–523 of the Senate amendment) (H.R. 2167 passed by the House) 250
B. Railroad Retirement Provisions (secs. 531–534 of the Senate amendment) (H.R. 2167 passed by the House) 252
C. Reports and Study (secs. 515 and 517 of the Senate amendment) (H.R. 2167 passed by the House) 253
VII. Social Security Act Amendments; Medicare and Medicaid Amendments 254
A. Social Security Act Amendments 254

Page
1. Interim benefits in cases of delayed final decisions (sec. 401 of the House bill) 254
2. Application of earnings test in year of individual's death (sec. 402 of the House bill) 254
3. Phase-out of reduction in "windfall" benefit (sec. 403 of the House bill) 255
4. Denial of benefits to individuals deported or ordered deported on the basis of association with the Nazi Government of Germany during World War II (sec. 404 of the House bill and sec. 603 of the Senate amendment) .. 256
5. Modification in the term of office of public members of the Social Security Boards of Trustees (sec. 405 of the House bill and sec. 800F of the Senate amendment) 257
6. Continuation of disability benefits during appeal (sec. 406 of the House bill and sec. 601 of the Senate amendment) 258
7. Extend social security exemption for members of certain religious faiths (sec. 407 of the House bill) 258
8. Blood donor locator service (sec. 408 of the House bill) 259
9. Payment of lump-sum death benefits to legal representatives of widows and widowers who die before receiving payment (sec. 409 of the House bill) 260
10. Requirement of social security number as a condition for receipt of social security benefits (sec. 410 of the House bill and sec. 604 of the Senate amendment) 260
11. Substitution of certificate of election for application to establish entitlement for certain reduced widow's and widower's benefits (sec. 411 of the House bill and sec. 605 of the Senate amendment) 261
12. Calculation of windfall benefit guarantee amount based on pension amounts payable in the first month of concurrent entitlement rather than concurrent eligibility (sec. 412 of the House bill) 262
13. Consolidation of reports on continuing disability reviews (sec. 413 of the House bill and sec. 602 of the Senate amendment) 262
14. Exclusion of employees separated from employment before January 1, 1989, from rule including as wages taxable under FICA certain payments for group-term life insurance (sec. 414 of the House bill) 263
15. Treatment of earnings of corporate directors (sec. 415 of the House bill) 263
16. Clarification of applicability of government pension offset to certain Federal employees (sec. 416 of the House bill) 264

Page

17. Clarification regarding social security coverage for certain civil servants (sec. 417 of the House bill) 265
18. Technical corrections to OASDI (sec. 418 of the House bill and sec. 606 of the Senate amendment) 266
19. National Academy of Social Insurance (secs. 901–916 of the Senate amendment) 266
20. Exemption from FICA tax for certain agricultural workers (sec. 709 of the Senate amendment) 267
21. Certain State or local government pension contributions not included in FICA wage base (sec. 762 of the Senate amendment) 268
22. Required use of consumer price index for urban consumers by Federal officer or agency in determining certain cost-of-living increases (sec. 800R of the Senate amendment) 268
23. Reports regarding certain disability applications involving AIDs related complex (ARC) (sec. 800U of the Senate amendment). 269

B. Public Assistance Provisions 270
1. Moratorium on emergency assistance and AFDC special needs regulations (sec. 611 of the Senate amendment) (H.R. 4352 passed by the House) 270
2. Disregard of certain housing assistance for SSI recipients (sec. 423 of the House bill and sec. 612 of the Senate amendment) 271
3. Moratorium on AFDC quality control (sec. 421 of the House bill) (H.R. 1720 passed by the Congress and enacted (P.L. 100–485)) 272
4. AFDC foster care independent living initiatives (sec. 424 of the House bill and sec. 921 of the Senate amendment) 272

C. Provision Regarding Report of National Commission on Children: Delay in Commission's Reporting Date (sec. 621 of the Senate amendment) 274

D. Unemployment Compension Provisions 274
1. Due dates for self-employment demonstration projects for unemployment compensation beneficiaries (sec. 422 of the House bill) 274
2. Exemption of certain religious schools from Federal unemployment tax (sec. 1001 of the Senate amendment) 275

E. Medicare and Medicaid Amendments (secs. 631, 800K, 800Q, 800S, 800T, 801–815, and 1002 of the Senate amendment) 275
1. Medicare provisions 275
2. Medicaid provisions 280

Trade Provisions 285

A. Iraqi Trade Sanctions (secs. 1201–1209 of the Senate amendment) 285

Page
B. Other Trade Provisions 286
1. Trade technicals; certain tariff schedules (sec. 800V of the Senate amendment) 286
2. Limitation on CBI ethanol imports (sec. 761 of the Senate amendment) 287
3. Foreign trade zones (sec. 1003 of the Senate amendment) 287
4. Study of U.S.-Japan trade and technology (sec. 800AA of the Senate amendment) 288
5. GAO study on the Small Business Innovation Research Program (sec. 734 of the Senate amendment) 289
Manassas Battlefield National Park Amendments (secs. 1101–1105 of the Senate Amendment) (H.R. 4526 passed by the House) 290

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 4333) to make technical corrections relating to the Tax Reform Act of 1986, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck out all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment which is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clarifying changes.

TECHNICAL CORRECTION PROVISIONS

I. Technical Corrections to the Tax Reform Act of 1986

House Bill

The House bill contains technical, clerical, and conforming amendments to the Tax Reform Act of 1986.

Senate Amendment

The Senate amendment also contains technical, clerical and conforming amendments to the Tax Reform Act of 1986. The substantive differences between the House bill and the Senate amendment are as follows:

Individual

The Senate amendment is the same as the House bill.

Capital Cost

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment does not contain two provisions in the House bill (sec. 102(d)(17)(A) and 102(k)(3)(BB)) relating to specific projects;

(2) the Senate amendment clarifies that refunds payable under Act section 212 (relating to cash-out of investment tax credits) generally may not be offset by the IRS against liabilities for the excise tax imposed under section 4971 for failure to meet minimum funding standards for qualified plans;

(3) the Senate amendment provides that no depreciation deduction is allowed with respect to any railroad grading or tunnel bore; the House bill provides 50-year straight line depreciation under ACRS for railroad grading or tunnel bores;

(4) the Senate amendment includes a modification of a transitional exception (sec. 102(k)(6)) for a specific project reflecting circumstances arising due to the delay in enacting technical corrections; and

(5) the Senate amendment provides that for purposes of calculating the 40-percent test for the midquarter convention, the taxpayer may elect to include or not include property placed in service and withdrawn from service in the same taxable year, for taxable years beginning before 1989.

Capital Gains and Losses

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment does not contain the provision in the House bill limiting capital losses of noncorporate taxpayers to taxable income.

Agriculture and Natural Resource

The Senate amendment is the same as the House bill.

Tax Shelters; Interest Expense

The Senate amendment is the same as the House bill.

Corporate

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment clarifies the treatment of warrants under a transitional rule relating to the 1976 Act version of section 382;

(2) the Senate amendment provides that the provision relating to outbound transfers applies to transfers on or after June 21, 1988, other than reorganizations for which a plan of reorganization had been adopted before June 21, 1988; the House bill applies to transfers on or after June 21, 1988;

(3) the House bill limits the net built-in gain subject to tax in the case of an S corporation to the corporation's taxable income with a carryforward of any net built-in gain in excess of taxable income for the year;

(4) the Senate amendment provides that the clarification of Treasury's regulatory authority with respect to RICs and REITs does not apply if by June 10, 1987, the board of directors of one of the parties to the reorganization adopted a resolution to solicit shareholder approval for the transaction or the shareholders or the board of directors of one of the parties to the reorganization approved the transaction;

(5) the legislative history to the Senate amendment indicates that the Internal Revenue Service is expected to use its section 7805(b) authority to provide relief to adversely affected taxpayers in the case of a RIC or REIT disposing of built-in gain assets; and

(6) the Senate amendment provides that, except as the Treasury Secretary provides by regulations, any payment to a real estate investment trust under a bona fide interest rate swap or cap agreement entered into by the real estate investment trust to hedge indebtedness incurred to acquire or carry real estate assets is treated as income qualifying under the 95-percent test, and the agreement is treated as a security under the 30-percent test.

Minimum Tax

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment provides that the effective date of the provision relating to incentive stock options applies to options exercised after December 31, 1987 (rather than October 16, 1987); and

(2) the Senate amendment clarifies the depreciation treatment under the adjusted current earnings preference in the case of leased property where the taxpayer does not claim book depreciation.

Accounting

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment clarifies that an S corporation is not treated as a tax shelter for purposes of the limitation on the use of

the cash method of accounting merely by reason of being required to file a notice of exemption from registration with a State agency if all corporations that offer securities for sale in the State are required to register or file a notice of exemption from registration;

(2) the Senate amendment clarifies that the four-year spread of income applies to common trust funds required to change their taxable year;

(3) the committee report to the Senate amendment does not contain the language in the House report providing that no inference is intended concerning the propriety of any method of accounting for utility services under prior law that did not strictly adhere to the meter reading method for all customers of a taxpayer; and

(4) the Senate amendment provides that under the simplified method for allocating storage and handling costs between ending inventory and cost of goods sold, the amount of storage or handling costs included in ending inventory is to be determined by dividing the amount of storage or handling costs by the beginning inventory balance and purchases during the year and multiplying the result by the amount of costs in ending inventory that are considered purchases for the year.

Financial Institutions

The Senate amendment is the same as the House bill, except—

(1) the House bill provides that, in the case of a large bank, an election made by a member of a parent-subsidiary controlled group concerning the method of recapturing an existing bad debt reserve is binding on all banks that are members of such parent-subsidiary controlled group for the taxable year of the election; the Senate amendment provides that each member of a parent-subsidiary controlled group may make a separate election concerning the method of recapturing its existing bad debt reserve.

Insurance

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment clarifies that the rule of prior section 825(g), eliminating loss carryovers of corporations that are exempt from tax or that elect to be taxed only on taxable investment income, continues to apply; and

(2) the Senate amendment clarifies that in the case of an interinsurer or reciprocal underwriter that reports on its annual statement reserves for unearned premiums net of premium acquisition expenses, the difference between (1) the amount of the reserves at the end of the most recent taxable year beginning before January 1, 1987, and (2) 80 percent of the sum of the reserves as of such date and such premium acquisition expenses is to be taken into account ratably over a 6-year period as a section 481(a) adjustment.

Pensions; Employee Benefits

The Senate amendment is the same as the House bill, except—

(1) the legislative history to the Senate amendment provides that any organization that maintained a section 401(k) plan before July 2, 1986, and that subsequently becomes a tax-exempt organization satisfies the grandfather rule in the 1986 Act for tax-exempt organization maintaining section 401(k) plans;

(2) the Senate amendment provides that the partial interest exclusion for loans to an employee stock ownership plan (sec. 133) is available with respect to a refinanced loan that would qualify for the exclusion but for the fact that the loan it is refinancing is a loan between corporations that are members of the same controlled group;

(3) the Senate amendment provides that the first diversification election under the ESOP diversification rules (sec. 401(a)(28)) may generally be provided in either 1988 or 1989;

(4) the Senate amendment provides that permissible rollovers from retirement bonds (sec. 409) may be delayed under rules similar to temporary Treasury rules delaying the application of the required distribution rules to individual retirement arrangements (IRAs);

(5) the Senate amendment codifies IRS Notice 88-68 by providing that section 457 does not apply to bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, and death benefit plans; and

(6) the Senate amendment does not contain the language in the legislative history to the House bill directing the Secretary to minimize the administrative burdens required for an employer to qualify for the relief from the employee leasing recordkeeping requirements.

Foreign Tax

The Senate amendment is the same as the House bill, except—

(1) where the House bill denies look-through treatment in determining the separate foreign tax credit limitation applicable to earnings distributed by a controlled foreign corporation to a shareholder who was not a U.S. shareholder when the earnings were derived, the Senate amendment follows the House bill but provides regulatory authority to permit look-through treatment in a case where the shareholder is a minority U.S. shareholder in the controlled foreign corporation;

(2) the Senate amendment provides that gain derived by a U.S. resident on distributions in liquidation of a possession corporation that derived more than 50 percent of its gross income from an active trade or business in that possession over the prior three years shall be foreign source income subject to a separate foreign tax credit limitation;

(3) the Senate amendment clarifies a House bill provision, which conforms the treatment of gains on sales of stock in foreign corporations that are controlled foreign corporations under the captive insurance rules with the treatment accorded to gains on sales of controlled foreign corporation stock in general, so that the provision is effective for gains on sales of stock in foreign captive insurance companies regardless of whether those companies have elected to treat their related person insurance income as income effectively connected with the conduct of a U.S. trade or business;

(4) the Senate amendment provides that previously unused post-1982, pre-1987 deficits attributable to foreign base company oil related activities can be carried forward to post-1986 years to reduce income inclusions under subpart F; and

(5) the Senate amendment modifies the House bill provision regarding the treatment of unidentified conflicts between the 1986 Act and treaties in the following manner: (a) it provides a permanent rule providing that neither a provision of a treaty nor a law of the United States affecting revenue shall have preferential status by reason of its being a treaty or a law, rather than a rule providing that the 1986 Act and the technical corrections bill shall apply notwithstanding previously ratified treaties, (b) it clarifies that an item is excludable from gross income of a taxpayer pursuant to those treaty provisions that continue to operate unaffected by subsequently enacted statutes, and (c) it provides disclosure requirements, and penalties for failure to disclose, with respect to positions taken that are based on treaty provisions that pre-date tax legislation.

Tax-Exempt Bonds

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment provides an effective date of June 10, 1987, rather than September 25, 1985, for an amendment relating to advance refundings of pre-September 25, 1985, pension arbitrage bonds;

(2) the Senate amendment does not contain a provision (sec. 113(g)(3)(C)) relating to the scope of the tax-exempt financing of a specified stadium project;

(3) the Senate amendment (sec. 113(g)(34)) differs from the House bill by requiring that at least 900 units of student housing be built rather than at least 790 units in order for a specific project to issue tax-exempt bonds outside the $150 million bond limit imposed on 501(c)(3) organizations; and

(4) the Senate amendment does not include a provision specifying the application of the technical corrections to Title XIII of the Reform Act in accordance with section 1302 of that Act.

Trusts and Estates; Minor Children; Generation-Skipping Transfer Tax

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment provides that if no executor or administrator is appointed, qualified and acting within the United States, then any person in actual or constructive possession of any property of the decedent will be treated as the executor for purposes of the generation-skipping tax.

Compliance and Tax Administration

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment provides that State legislation merely conforming to or reenacting Federal law establishing a national filing system for instruments affecting interests in personal property does not constitute a second office designated by the State for filing notices of Federal tax liens;

(2) the Senate amendment extends immunity from liability of a person honoring an IRS levy to apply not only with respect to the delinquent taxpayer but also any other person; and

(3) the Senate amendment conforms the statute of limitations rule for levies to that for liens so that if a timely proceeding in

court for the collection of tax is commenced, the period during which the tax may be collected by levy shall not expire as long as the tax is collectible.

Tax-Exempt Organizations

The Senate amendment is the same as the House bill.

Miscellaneous

The Senate amendment is the same as the House bill, except—

(1) the Senate amendment clarifies that the basis of a bond is increased by market discount included in income;

(2) the Senate amendment does not include the provision in the House bill which clarifies the present law exclusion from gross income of certain payments received under environmental and conservation programs;

(3) the Senate amendment does not contain the provision in the House bill deleting the provision of the 1986 Act regarding the compensation of ocean freightforwarders; and

(4) the Senate amendment corrects a cross-reference to the gasoline tax registration and bonding procedure.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with respect to common provisions. Specifically, the conference agreement includes the following provisions:

Individual

The conference agreement follows the House bill and the Senate amendment.

Capital Cost

The conference agreement follows the Senate amendment with several modifications. First, the conference agreement contains the provision in the House bill relating to depreciation of railroad grading and tunnel bores and clarifies that as under prior law the section 1245 depreciation recapture rules apply to such depreciation. Second, the election described in the item listed as number 5 above (relating to the midquarter convention) will apply to taxable years beginning on or before March 31, 1988. Third, the conference agreement revises the language of section 1002(d)(26) of the bill with respect to new section 204(a)(35) of the 1986 Act. Fourth, the conference agreement deletes that portion of section 1002(k)(3) of the bill with respect to new section 251(d)(4)(GG) of the 1986 Act.

Further, the conferees wish to clarify in connection with the included provision relating to the midquarter convention, that transfers of property between members of the same affiliated group filing a consolidated return shall be disregarded. In particular, although depreciable basis is generally to be used in applying the 40-percent test, basis adjustments resulting from such transfers shall be disregarded.

Finally, the conferees wish to clarify that the credit ordering rules included in the bill affect only the order in which credits arising in a single year are used. These rules do not affect the present-law rule that requires that credits arising in the earliest year be used first (the "FIFO rule").

Capital Gains and Losses

The conference agreement follows the House bill. In addition, the conference agreement modifies the provision relating to capital losses. The agreement provides that the amount that the capital loss carryforwards to the subsequent taxable year are reduced by reason of section 1212(b)(2) cannot exceed the taxpayer's taxable income for the year increased by (1) the amount of capital losses allowed for the year under paragraph (1) or (2) of section 1211(b) and (2) the deduction for personal exemptions. Where the deductions exceed gross income for the year, the computation is made starting with a negative number.

Agriculture and Natural Resources

The conference agreement follows the House bill and the Senate amendment.

Tax Shelters; Interest Expense

The conference agreement follows the House bill and the Senate amendment.

Corporate

The conference agreement follows the Senate amendment; except the agreement does not contain the item listed as number 5 above, and does follow the House version of the S corporation tax on net built in gains.

Section 621(f)(5) of the Tax Reform Act of 1986 provides relief from the amendments made by that Act to sections 382 and 383 of the Code in the case of certain transactions involving a title 11 or similar case if a petition in such case was filed with the court before August 14, 1986. The relevant provisions of section 368 that define a title 11 or similar case provide that in certain proceedings involving specified financial institutions where the relevant proceeding is before a Federal or State agency, the agency shall be treated as a court. The conferees clarify that for purposes of the transition rule contained in section 621(f)(5), the petition shall be considered filed with the court in the case of such agency proceedings no later than the time the relevant agency action has occurred. As one example, in the case of an insolvent thrift institution subject to regulation by the Federal Savings and Loan Insurance corporation ("FSLIC"), a petition will be deemed to have been filed no later than the date such agency assumes control over such institution through the appointment of a receiver. No inference is intended that other action might not also constitute the filing of a petition in appropriate cases, consistent with the relief granted to transactions covered by the relevant provisions of section 368.

The conference agreement clarifies that the tax on transfers of residual interests of REMICs to disqualified organizations and the tax on pass-through entities and nominees are treated as excise taxes for administrative purposes, except that the Tax Court has jurisdiction over deficiencies of these taxes.

The conferees clarify the definition of a "qualified corporation" under the transition rules of section 633(d)(5) of the Tax Reform Act of 1986 in the case of a corporation which adopted a plan of liquidation prior to March 31, 1988, and is completely liquidated prior to January 1, 1989. If, on August 1, 1986, and at all times thereafter before such liquidation, more than 50 percent, by value, of the corporation's stock was owned by 10 or fewer qualified persons, such corporation would come within the definition of "qualified corporation" under section 633(d)(5) of the Tax Reform Act of 1986 regardless of how long any such shareholders have held their stock and regardless of whether or not such shareholders were the same throughout the applicable period.

In addition, the conferees clarify the definition of a "qualified group" under section 633(d) of the Tax Reform Act of 1986, as amended by this Act, in connection with the following case. One hundred percent of the shares of a corporation are owned by two shareholders until mid-1987, each holding 50 percent of the issued and outstanding shares. These shareholders had owned their shares for more than five years. Subsequently, after mid-1987, 100 percent of the issued and outstanding shares of the corporation were owned by one of the two original shareholders. This shareholder had owned his shares for more than five years. These shareholders would come within the definition of "qualified group" under section 633(d) of the Tax Reform Act of 1986. However, it may not be appropriate to extend this treatment to situations where an insubstantial shareholder acquires more than 50 percent of the stock of a corporation.

Finally, the conference agreement clarifies the provision in the Act relating to the treatment of accounts receivable for purposes of the 25-percent built-in gain or loss rule in connection with the limitations on net operating losses. Under the Tax Reform Act of 1986, for purposes of calculating the 25-percent threshold test, assets are to be reduced by cash and cash items, which include accounts receivable. The Act provides the Treasury authority to change this rule by regulation. The conferees expect that such regulations would be prospective in effect and thus would not apply to ownership changes in completed transactions and in transactions as to which there is a binding contract, including a binding purchase offer, before the date of issuance of such regulations.

Minimum Tax

The conference agreement follows the Senate amendment except the agreement follows the House bill by not containing the provision relating to depreciation by certain lessors. The conferees agree with the colloquy appearing on 133 Cong. Rec. S 15456 (Oct. 11, 1988), relating to unrelated business taxable income.

Accounting

The conference agreement follows the Senate amendment, except that the conferees agree with the language of the House committee report with respect to the meter reading method.

In addition, under the conference agreement, a participant in a common trust fund is required to report the income from a short year resulting from a required change in taxable years ratably over four years.

Financial Institutions

The conference agreement follows the Senate amendment.

Insurance

The conference agreement follows the Senate amendment, with the following clarification of the provision relating to tax-exempt organizations engaged in insurance activities.

Under the 1986 Act, the provision relating to organizations engaged in commercial-type insurance activities did not alter the tax-exempt status of health maintenance organizations (HMOs). HMOs provide physician services in a variety of practice settings primarily through physicians who are either employees or partners of the HMO or through contracts with individual physicians or one or more groups of physicians (organized on a group practice or individual practice basis). The conference agreement clarifies that, in addition to the general exemption for health maintenance organizations, organizations that provide supplemental health maintenance organization-type services (such as dental or vision services) are not treated as providing commercial-type insurance if they operate in the same manner as a health maintenance organization.

Pensions; Employee Benefits

The conference agreement follows the Senate amendment with the following modifications.

With respect to the provisions permitting distributions from a section 401(k) plan following termination of the plan, the conference agreement clarifies that, as under proposed Treasury regulations, a distribution may be made notwithstanding the fact that the employer maintains an employee stock ownership plan (ESOP) (as defined in section 4975(e)(7) of the Code) after the termination.

The conference agreement follows the House bill with respect to the provision directing the Secretary to minimize the administrative burdens required for an employer to qualify for the relief from the recordkeeping requirements under the employee leasing rules (sec. 414(n)).

The conference agreement does not adopt the provision in the Senate amendment that bona fide vacation pay plans, severance pay plans, and certain other benefit plans are not subject to section 457. The conference agreement modifies section 457, as discussed under part V of Substantive Revenue Provisions.

As described below under Substantive Revenue Provisions, the conference agreement modifies a provision in technical corrections relating to the partial interest exclusion for loans to an employee stock ownership plan (sec. 133).

Foreign

The conference agreement generally follows the Senate amendment. The conferees also wish to clarify certain provisions contained in the conference agreement.

With respect to the definition of the term "noncontrolled section 902 corporation," the Senate amendment follows the House bill but also provides regulatory authority to not treat dividends from a controlled foreign corporation, out of earnings for periods during which the corporation was a controlled foreign corporation but the dividend recipient was not a U.S. shareholder with respect to the corporation, as dividends from a noncontrolled section 902 corporation. The conferees adopted the Senate amendment's modification to the House bill because they are concerned with the potential administrative difficulties for both taxpayers and the IRS that might arise in applying the House bill, which requires a U.S. shareholder receiving distributions of controlled foreign corporation earnings to determine whether or not those dividends are attributable to earnings that predate the shareholder's status as a U.S. shareholder in the controlled foreign corporation. The conferees anticipate the Secretary will exercise the regulatory authority provided by the agreement to generally allow look-through treatment of dividends from controlled foreign corporations, except in those cases where any administrative burden associated with the rule of the House bill is insignificant or is otherwise warranted by the need to prevent cross-crediting involving sufficiently distinct streams of income and the taxes thereon. As one example, the conferees anticipate that where a first-tier U.S.-controlled foreign corporation sells all or a majority of the stock of its wholly-owned foreign subsidiary to a U.S. corporation, dividends from the acquired foreign corporation to the acquiring U.S. corporation out of pre-acquisition earnings and profits will be subject to the separate noncontrolled section 902 corporation foreign tax credit limitation. In such a case the conferees do not believe it is administratively difficult for the acquirer to trace the dividends paid by the acquired foreign corporation to pre- or post-acquisition earnings, as the case may be.

With respect to the provision of the Reform Act clarifying and codifying the prior regulatory rule causing certain foreign government subsidies to reduce the creditable portion of certain foreign taxes (see sec. 1204 of the Reform Act and Treas. Reg. sec. 1.901-2(e)(3)), the conferees wish to reiterate and to clarify that no inference should be drawn from the enactment of that provision as to the validity or invalidity, or as to the proper interpretation, of the regulation for years prior to the effective date of the Reform Act provision.

With respect to the treatment of gains on sales of stock in foreign corporations that are controlled foreign corporations under the captive insurance rules, the Senate amendment modifies the House bill provision that conforms the treatment of such gains with the treatment accorded to gains on sales of controlled foreign corporation stock in general, in order to clarify that the provision is effective regardless of whether those companies have elected to treat their related person insurance income as income effectively connected with the conduct of a trade or business in the United States.

With respect to passive foreign investment companies, the conferees wish to clarify the intended scope of certain of the agreement's provisions. First, in connection with the agreement's provision that gives regulatory authority to deny the benefits of nonrecognition treatment in the case of a transfer of stock in a passive foreign investment company (PFIC), the conferees intend this regulatory authority to be exercised in cases where the deferred tax and interest inherent in the appreciation of PFIC stock are potentially avoidable. For example, if appreciated stock in a PFIC is given by a U.S. person to a foreign person, the deferred tax and interest inherent in the appreciation of the stock would not be collected on the eventual disposition of the stock unless the gift is treated as a taxable sale at the time of the gift. On the other hand, the conferees do not intend this regulatory authority to be exercised in cases where there is no potential to avoid the deferred tax and interest. For example, the conferees generally do not believe that an otherwise nontaxable reorganization of a PFIC should give rise to a recognition event where a U.S. person exchanges stock in a PFIC for stock in another PFIC and no step-up in basis occurs.

Second, in connection with the agreement's provision that gives regulatory authority to treat U.S. persons as having received a distribution with respect to, or as having disposed of, stock that is indirectly held in a PFIC because of the attribution rules, the conferees intend this regulatory authority to be exercised where necessary to prevent the avoidance of the imposition of interest. For example, if a U.S. person owns stock in a PFIC that in turn wholly owns the stock in a second-tier PFIC, and the second-tier PFIC distributes its earnings to the upper-tier PFIC on an annual basis, the conferees do not believe the U.S. person should be considered to receive his or her share of the distribution unless the distribution is somehow made available to the U.S. person. The conferees believe this treatment should prevail regardless of whether the PFICs are qualified electing funds. On the other hand, if the second-tier PFIC in the example above is not a qualified electing fund and the upper-tier PFIC is, then the conferees believe that a disposition by the U.S. person of stock in the upper-tier PFIC should be treated as a disposition of stock in the second-tier PFIC in cases where, for example, the second-tier PFIC does not annually distribute its earnings to the upper-tier PFIC.

Third, in connection with the agreement's provision that treats direct and indirect loans from a PFIC that is a qualified electing fund to a shareholder in the PFIC as a distribution to that shareholder, the conferees generally do not believe that a loan from the PFIC to a related foreign corporation should be treated as an indirect loan to the PFIC's shareholder. However, if the related foreign corporation is used as a conduit, then the conferees believe it would be appropriate to treat the loan as an indirect loan.

With respect to the branch level interest tax, the conferees do not intend that section 884(f)(1)(B), to the extent that provision causes interest paid by a non-U.S. branch of a foreign corporation to be U.S. source, to apply for section 936 purposes. That is, if a section 936 company receives interest from a non-U.S. branch of a foreign corporation, that interest is intended to be treated as other than U.S. source for purposes of determining whether it is qualified possession source investment income.

With respect to the interaction of treaties and statutes, the House recedes to the Senate amendment with modifications. First, the agreement provides that where a taxpayer takes the position that a U.S. treaty overrules (or otherwise modifies) an internal revenue law of the United States, then disclosure on the tax return, or in a manner prescribed by the Secretary, shall be made regardless of whether the law purported to be overruled or otherwise modified was enacted before or after the treaty was enacted. The conferees intend this provision to apply in any case where the taxpayer takes a position in reliance on a treaty and that position is contrary to the result that the Internal Revenue Code (or any other internal revenue laws of the United States) would dictate in the absence of the treaty.

Second, the agreement provides that the penalty for each failure to comply with the disclosure requirement shall be $10,000 (in the case of taxpayers that are C corporations), or $1,000 in the case of other taxpayers.

Third, the agreement clarifies the scope of the Treasury's authority to waive the disclosure requirement, by providing that such waiver shall be by regulation, and shall be applicable with respect to classes of cases for which the Secretary finds that waiver of the requirement will not impede the assessment or collection of tax. (The agreement does not make any modifications to the Senate amendment provision regarding the Secretary's authority to waive a penalty, with respect to a particular taxpayer, for that taxpayer's failure to disclose those positions for which the disclosure requirements have not been waived.)

Fourth, the agreement modifies the Code provision that serves as a cross reference to treaties (sec. 894(a)), in light of the Senate amendment's codification of the relationship between treaties and statutes. In place of the existing Code provision, which states that a taxpayer can exclude items of income from gross income, and therefore be exempt from income tax on those items, where such treatment is called for by treaty, the agreement provides that the provisions of the Internal Revenue Code are to be applied to any taxpayer with due regard to any treaty obligation of the United States which is applicable to such taxpayer. The agreement further clarifies that in determining what regard is due to a treaty, reference must be made to the principle that neither the treaty nor any relevant law shall have preferential status by reason of its being a treaty or law.

Thus, as is true of current section 894(a), the agreement's provision adds no operative rules to be applied in determining the relationship of the Code (or other tax law) and a treaty, but rather states the constitutional principle that such determinations are relevant in determining tax liabilities. Where the relationship of treaties and statutes must be determined, the agreement simply provides for giving the treaty that regard which it is due under the ordinary rules of interpreting the interactions of statutes and treaties. For example, where a treaty obligation calls for a certain tax result with respect to a particular item of income (whether that result is to exempt that item of tax or reduce the rate of U.S. tax on that item), that result differs from the result called for under a Code provision, and that treaty obligation has not been superseded for internal U.S. law purposes, the agreement acknowledges that taxpayers and the IRS can look beyond the Code to determine the proper tax treatment of the item of income in question. On the other hand, where a treaty obligation has been superseded for internal U.S. law purposes, no effect need be given to the treaty under the agreement's provision.

Finally, with respect to the agreement's provision that restricts the operation of section 338(h)(10) for source and foreign tax credit purposes, the conferees do not believe the Senate amendment's intended effect on the interaction between the agreement's provision and Code section 904(f), relating to recapture of overall foreign losses (OFLs), is appropriate. The conferees intend instead that section 338(h)(10) operate as it would under current law to the extent a deemed asset sale would give rise to foreign source income that would be recharacterized as U.S. source income under section 904(f).

The conferees believe this approach, as opposed to the approach set forth in the committee report accompanying the Senate amendment, is more consistent with the operation of an election under section 338(h)(10) by a target corporation that has an OFL. When such an election has been properly made, the following events have occurred or will be deemed to occur: the stock of a U.S. subsidiary in a U.S. consolidated group has been purchased by an unrelated corporation, the subsidiary is deemed to have sold its assets and is treated as a member of the selling consolidated group with respect to that deemed sale, and the subsidiary is considered to distribute its assets in liquidation to its U.S. parent. As a result, the tax attributes of the subsidiary (including, for example, its OFL) become attributes of the U.S. parent. In contrast with the usual result of a stock sale, the U.S. subsidiary in the hands of the purchaser does not retain these tax attributes, and receives a stepped-up basis in its assets. (The Senate amendment contemplated that the OFL would have transferred with the U.S. subsidiary when its stock was sold and that the OFL would have been recaptured when the assets of the subsidiary were actually sold. As described above, the conferees understand that the OFL (as well as any other attribute) does not transfer with the U.S. subsidiary, and that the assets receive a stepped-up basis, which would prevent the OFL from being recaptured upon the actual sale of those assets.)

The conferees also believe that the above approach preserves the intended effect of the agreement's provision, as well as the intended effect of the OFL rules. The OFL rules require U.S. sourcing of foreign income to ensure that foreign losses do not permanently shelter U.S. income from U.S. tax. The agreement's provision, on the other hand, requires U.S. sourcing of deemed gain income to prevent the sheltering from U.S. tax of untaxed foreign source income because of unrelated, excess foreign tax credits. Regardless of whether section 904(f) operates unaffected by the agreement's provision, any income that might be foreign source because of a section 338(h)(10) election will be recharacterized as U.S. source and therefore will allow the United States to recoup the tax that was previously lost because of foreign losses. Income that is not recharacterized under section 904(f) will continue to be sourced as stock gain income and the U.S. tax on such income will not be sheltered by unrelated, excess foreign tax credits. Since the objectives of both the OFL rules and the agreement's provision are served by the above treatment, the conferees believe it is appropriate to reduce the OFL.

Therefore, under the agreement, the conferees intend the U.S. selling consolidated group to be able to treat the stock sale as an asset sale for purposes of reducing its overall foreign loss. Any gain remaining after the OFL is reduced or recaptured is intended to be sourced as stock gain income consistent with the agreement's provision.

Tax-Exempt Bonds

The conference agreement follows the House bill with two modifications. First, the technical correction in the House bill prohibiting advance refundings of pre-September 25, 1985, pension arbitrage bonds is modified to permit one advance refunding after September 25, 1985, of pension arbitrage bonds issued prior to September 26, 1985.

Second, the conference agreement follows the Senate amendment with respect to bonds issued for a specified student housing project which would qualify for relief from the $150 million bond limit imposed on 501(c)(3) organizations.

The conference agreement also clarifies that a technical amendment included in both the House bill and the Senate amendment permitting certain current refundings of transitioned bonds after issuance deadlines for original issuance of the bonds applies to transitional exceptions subject to special deadlines as well as to those subject to the general issuance deadlines for such bonds.

The conference agreement delays the effective date from June 30, 1987 until October 21, 1988, of a technical amendment clarifying that bonds issued for certain volunteer fire departments are exempt from private activity bond restrictions other than the public approval requirement and the prohibition on advance refundings.

In addition, the conferees wish to state their specific agreement with the colloquy appearing on 134 Cong. Rec. S 15456 (October 11, 1988), relating to bonds of public utility districts.

Trusts and Estates; Minor Children; Generation-Skipping Tax

The conference agreement follows the Senate amendment.

The conference agreement modifies the provision relating to the application of the minimum tax to the unearned income of minor children by providing that the minimum tax exemption of a minor child to whom section 1(i) applies cannot exceed the sum of $1,000 plus the child's earned income. Further, the child's minimum tax liability cannot exceed the amount that the parent's minimum tax liability would be increased if the parent's tentative minimum tax and regular tax were increased by that amount of the child's tentative minimum tax and regular tax. The provision will apply to taxable years beginning after December 31, 1988.

Also, the effective date of the generation-skipping transfer tax is clarified so that grandfathered property does not include transfers of qualified terminable interest property made after October 21, 1988, to mentally incompetent spouses. The rule that a "taxable termination" and a "taxable distribution" shall not include a transfer which would be a direct skip but for the deceased parent rule is deleted as unnecessary.

Compliance and Tax Administration

The conference agreement follows the Senate amendment.

In addition, the conference agreement allows individual taxpayers until April 15, 1989, and corporations until March 15, 1989, to pay their full income tax liabilities without incurring any additions to tax on account of underpayments of estimated tax to the extent the underpayments are attributable to changes in law made by the technical corrections titles of the bill.

Further the conferees note that the Internal Revenue Service policy (P-2-10, approved August 3, 1988) does not require taxpayers to pay interest on repayments of erroneous refunds if the Service was clearly at fault in making the refund and the taxpayer is cooperative in repaying it. The conferees expect the Service to apply this policy to refunds made by the Service where the taxpayer paid taxes in accordance with provisions contained in the technical corrections bills but the taxes were refunded to the taxpayer because the technical corrections provisions had not yet been enacted. Although the refunds were not erroneous at the time they were made, the retroactive effective date of the technical correction provisions means that the refunds should be treated as erroneous for purposes of this policy.

Tax-Exempt Organizations

The conference agreement follows the House bill and the Senate amendment.

Miscellaneous

The conference agreement follows the Senate amendment.

II. Technical Corrections to Other Tax Legislation

House Bill

The House bill contains technical, clerical, and conforming amendments to other tax legislation enacted in 1986 and 1987.

Senate Amendment

The Senate amendment contains technical, clerical, and conforming amendments to other tax legislation enacted in 1986 and 1987. The substantive differences between the House bill and the Senate amendment are as follows:

Superfund Revenue Act of 1986

The Senate amendment is the same as the House bill.

Harbor Maintenance Revenue Act of 1986

The Senate amendment is the same as the House bill.

Omnibus Budget Reconciliation Act of 1986

The Senate amendment is the same as the House bill.

Revenue Act of 1987

The Senate amendment is the same as the House bill, except—

Accounting item

(1) the Senate amendment corrects an error in the House bill relating to the timing of certain refunds of required payments made by partnerships or S corporations that elect a taxable year other than the required taxable year;

Partnership item

(2) the Senate amendment includes as qualifying income of publicly traded partnerships the income from any depletable property (rather than from property eligible for percentage depletion plus oil, gas, and timber);

Corporate items

(3) the Senate amendment provides that the rule in the House bill shortening the 5-year period for the common control exception under section 384 applies where the loss corporation was not in existence for five years as well as where the gain corporation was not in existence for five years;

(4) the legislative history to the Senate amendment clarifies that, with respect to the limitation on the use of preacquisition losses to offset built-in gains, not only post-affiliation gains or losses, but also pre-affiliation gains or losses which are not subject to limitation under the general rule, are not subject to limitation upon the merger of members of the same affiliated group;

Excise tax items

(5) the Senate amendment restores a provision of prior law, which was inadvertently deleted, exempting certain fuel used as supplies for vessels and aircraft in international commerce from the Leaking Underground Storage Tank Trust Fund excise tax;

(6) the Senate amendment clarifies the application of the wholesale dealer alcoholic beverage occupational tax in cases where a dealer in beer only also becomes a dealer in distilled spirits in a year for which the tax has been paid.

Pension and employee benefit items

(7) the Senate amendment provides that, in the case of certain plan spinoffs and similar transactions involving defined benefit plans (within a controlled group), assets in excess of the benefits that would have been provided immediately before the transaction (calculated as if the plan then terminated) are allocated on a proportional basis with exceptions (a) for plans that are terminated after spinoff, (b) for plans that are spun off from a multiple employer plan if, after the spinoff, no employer (or member of the same controlled group) maintaining the multiple employer plan maintains the spinoff plan, and (c) for multiemployer plans; and

(8) the Senate amendment provides that (a) the amount required to be reported for a year with respect to an employee with respect to dependent care assistance is the amount the employee incurs for dependent care assistance during the year, and (b) an employer may treat an amount electively contributed by an employee under a cafeteria plan for dependent care assistance for a year as an

amount incurred for dependent care assistance by the employee for the year.

Pension Protection Act

The Senate amendment is the same as the House bill, except—(1) the Senate amendment does not contain the provision in the House bill that deletes the special deduction rule in the case of liability payments made by controlled group members (sec. 404(g)).

Excise Tax on Certain Vaccines

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with respect to common provisions. Specifically, the conference agreement includes the following provisions:

Superfund Revenue Act of 1986

The conference agreement follows the House bill and the Senate amendment, with the following clarifications: (1) Treasury determinations with respect to petitions must be made after public notice and comment; and (2) a valid petition is one filed pursuant to procedures set forth by the Secretary not later than 180 days after enactment; petitions filed 180 days after enactment but prior to the publication of procedures shall be deemed to be valid.

In addition, the conference agreement provides that the Superfund environmental tax is deductible in computing adjusted book income for purposes of the minimum tax (but not the environmental tax).

Harbor Maintenance Revenue Act of 1986

The conference agreement follows the House bill and the Senate amendment, except that the due date for the cargo diversion study is changed to December 1, 1988.

Omnibus Reconciliation Act of 1986

The conference agreement follows the House bill and the Senate amendment.

Revenue Act of 1987

Accounting item

The conference agreement follows the Senate amendment.

Partnership item

The conference agreement follows the Senate amendment; except that (1) soil, sod, turf, water, mosses and (2) minerals from sea water, the air, or similar inexhaustible sources, shall not be treated as a mineral or natural resource.

In addition, the conference agreement follows the legislative history of the House bill with respect to income from certain transportation activities, with certain modifications. In the case of transportation activities with respect to oil and gas and products thereof, the conferees intend that, in general, income from transportation of oil and gas and products thereof to a bulk distribution center such as a terminal or a refinery (whether by pipeline, truck, barge or rail) be treated as qualifying income. Income from any transportation of oil or gas or products thereof by pipeline is treated as qualifying income. Except in the case of pipeline transport, however, transportation of oil or gas or products thereof to a place from which it is dispensed or sold to retail customers is generally not intended to be treated as qualifying income. Solely for this purpose, a retail customer does not include a person who acquires the oil or gas for refining or processing, or partially refined or processed products thereof for further refining or processing, nor does a retail customer include a utility providing power to customers. For example, income from transporting refined petroleum products by truck to retail customers is not qualifying income.[1]

The conference agreement also clarifies that, in the case of income from marketing of fertilizer, bulk or truckload sales to farmers in amounts of 1 ton or more are not considered retail sales giving rise to non-qualifying income.

With respect to what constitutes the addition of a substantial new line of business, it is the intention of the conferees that the Treasury Department provide prompt guidance to taxpayers, whether through the private ruling process or through the promulgation of revenue rulings or other announcements or regulations.

Corporate items

The conference agreement follows the Senate amendment.

The conferees clarify that, for purposes of the exception from the effective date provision concerning mirror subsidiary transactions in cases where 80 percent of the stock of the distributing corporation is acquired by the distributee, the ownership of stock of the distributing corporation by distributees which are members of the same affiliated group may be aggregated (to the extent permitted by prior law) in the case of distributions to any distributee with respect to stock owned by that particular distributee (determined without aggregation) on the later of December 15, 1987 or the date on which the grandfathered 80 percent acquisition occurred, either directly or indirectly through its proportionate ownership in a corporation that was also a member of the group on that date and that goes out of existence in the transaction. Indirect ownership through a corporation that goes out of existence in the transaction also includes ownership of stock acquired by the distributee through a merger into the distributee of one or more corporations that owned stock in the distributing corporation and were members of the same affiliated group as the distributee on the designated date.

In connection with the provisions of section 1503(e) of the Code relating to cancellation of indebtedness income, the conferees clarify that an upward basis adjustment through the inclusion of cancellation of indebtedness income in earnings and profits for purposes of section 1503(e) is permitted only to the extent that a tax attribute that was reduced under section 108 had resulted in a downward basis adjustment in the parent's stock of the subsidiary. It is also clarified that the upward adjustment for cancellation of indebtedness income cannot exceed the amount of the tax attribute that was reduced.

---

[1] Income from transportation and marketing of liquefied petroleum gas in trucks and rail cars or by pipeline, however, may be treated as qualifying income. See statement of Mr. Rostenkowski, 133 Cong. Rec. H 11968 (December 21, 1987); see also statement of Senator Bentsen, 133 Cong. Rec. S 18651 (December 22, 1987) (substantially similar language).

The conferees clarify the treatment of certain foreign corporations in determining whether corporations are members of an affiliated group for purposes of section 384(c)(6). Except as provided in regulations, in the case of an acquisition of assets or stock described in section 384(a) between or among corporations that were members of the same controlled group of corporations under section 384 at all times during the period beginning December 15, 1987 and ending on the date of such acquisition, in determining whether such corporations are members of an affiliated group for purposes of section 384(c)(6), section 1504 shall be applied without regard to subsection (b)(3) thereof relating to foreign corporations.

In addition, the conferees clarify that the greenmail tax does not apply in a situation where the stock of the taxpayer and all other shareholders is purchased at the same price, at essentially the same time and in a transaction which is substantially the same; that is, all shares are purchased with the same total present value of consideration per share, whether in the form of debt, debentures, or cash, with no additional consideration provided to any selling shareholder.

Excise tax items

The conference agreement follows the Senate amendment.

Pension and employee benefit items

The conference agreement follows the Senate amendment.

Pension Protection Act

The conference agreement follows the Senate amendment.

Excise Tax on Certain Vaccines

The conference agreement follows the House bill and the Senate amendment.

SUBSTANTIVE REVENUE PROVISIONS

I. DIESEL FUEL EXCISE TAX COLLECTION AND EXEMPTION PROCEDURES

Present Law

Exemptions from tax

The excise taxes on diesel and nongasoline aviation fuels are imposed on the sale of the fuels by a producer. Producers include wholesale distributors as well as refiners and certain other intermediate persons (other than retailers) in the distribution chain.

Exemptions are provided from the diesel fuel tax for State and local governments, farms, nonprofit educational organizations, and business use other than as a fuel in a highway vehicle. The tax on nongasoline aviation fuel applies only to fuel used in noncommercial aviation.

The Treasury Department is authorized to permit tax-free sales in the case of diesel fuel and nongasoline aviation fuel sold for use in a diesel-powered train, use as commercial aviation fuel, use other than as a motor fuel, use by a State or local government.

Treasury requirements

Producers of taxable fuels must register with the Treasury Department and satisfy Treasury bonding requirements.

Refunds of tax

(1) Since April 1, 1988, except in the four cases specified above, the exemptions from these fuels taxes are realized through refunds or credits, rather than tax-free sales as under prior law.

(2) A person entitled to a refund of $1,000 or more during any one of the first three calendar quarters of a year may file a claim for refund of tax paid for that quarter. Otherwise, the refund claim can be made only at the end of the year through an income tax credit.

Interest on refunds

As with other claims for refunds of excise tax, no interest is paid on refunds of excise taxes on diesel and nongasoline aviation fuels.

House Bill

Expansion of exempt persons able to purchase fuels tax-free

The House bill makes mandatory and extends the current provisions allowing certain tax-free purchases of diesel and nongasoline aviation fuels to all off-highway business users.

Treasury requirements

Under the House bill, exempt users may purchase such fuels tax-free when they purchase in bulk directly from a producer (including a wholesale distributor) and when Treasury-prescribed registration, financial responsibility, and information reporting requirements are met. Marine retail dealers who exclusively sell diesel fuel to water users are treated as producers. Treasury is authorized to issue regulations imposing expanded information reporting requirements on both seller and exempt purchasers.

Under the House bill, Treasury is required to issue initial rules regarding registration and financial responsibility requirements for exempt users purchasing fuel tax-free within 30 days after the date of enactment.

Refunds of tax

(1) *Special refund.*—The House bill provides a special, one-time refund for off-highway exempt users newly authorized to purchase diesel fuel tax-free from producers or importers. Such users may file a claim for refund of tax paid after March 31, 1988 and before July 1, 1988, regardless of the amount of tax.

(2) *Aggregate refund rule.*—No provision.

Interest on refunds

The special refund is to be made with interest, determined at the regular deficiency rate paid by the Federal Government on overpayments of tax. Purchases by the Federal Government, State and local governments, railroads, commercial airlines, and feedstock users are not eligible for this special, interest-bearing refund.

Effective date

The House bill applies to fuel sold after June 30, 1988.

Senate Amendment

Expansion of exempt persons able to purchase fuels tax-free

The Senate amendment is the same as the House bill, except it also extends the tax-free purchase rule to private buses currently eligible for a full or partial refund of the diesel fuel tax.

Treasury requirements

The Senate amendment is the same as the House bill, except that Treasury is required to issue initial rules regarding registration and financial responsibility requirements for exempt users before October 1, 1988.

Refunds of tax

(1) *Special refund.*—The Senate amendment is the same as the House bill, except that the claim for the special refund may be made for tax paid after March 31, 1988, and before October 1, 1988.

(2) *Aggregate refund rule.*—Under the Senate amendment, the present-law quarterly refund threshold is changed so that an exempt user may file for a refund if at least $750 in tax (in the

aggregate) is paid as of the end of any of the first three calendar quarters (without waiting until after the end of the year).

Interest on refunds

The Senate amendment with respect to interest on the special refund is the same as the House bill, except that the interest is to be determined at the interest rate charged by the Federal Government on tax deficiencies.

Also, the Senate amendment provides that where fuel is purchased tax-paid by an exempt user (e.g., from a retail dealer), State and local governments and off-highway exempt users (other than bus operators) will be paid interest on refund claims at the regular deficiency rate.

Effective date

The Senate amendment applies to fuel sold after September 30, 1988.

Conference Agreement

The conference agreement generally follows the House bill,[1] except for the following modifications:

(1) The tax-free purchase rule is extended to private buses currently eligible for a full or partial refund of the diesel fuel tax.

(2) The quarterly refund threshold is changed so that an exempt user may file for a refund if at least $750 in tax (in the aggregate) is paid as of the end of any of the first three calendar quarters (without waiting until after the end of the year). As under present law, no more than one claim may be filed in any calendar quarter. Also, the minimum claim amount is $750.

(3) Off-highway exempt users newly authorized to purchase tax-free fuel from a producer or importer may file a claim for a one-time refund (with interest) of tax paid after March 31, 1988 and before January 1, 1989, regardless of the amount of tax. Interest on this special refund is to be determined at the regular deficiency rate paid by the Federal Government on overpayments of tax. Amounts that have already been claimed on a quarterly claim for refund under section 6427 or that have been (or will be) claimed as a credit against other tax payments are not eligible for this special one-time interest bearing refund.

(4) Claims for the special, interest-bearing refund may be made before July 1, 1989. The Treasury Department will have 30 days after enactment to issue guidance on how to make these claims. Further, refund claims for the excise tax paid on diesel and non-gasoline aviation fuels for the period ending September 30, 1988, shall be considered timely filed if filed before July 1, 1989.

(5) The Treasury Department is given regulatory authority to allow retail sellers to sell diesel fuel tax-free to marine users even though such retail operations may sell a *de minimis* amount of

---

[1] The conferees wish to state specifically their agreement with a colloquy between Senators Boren, Baucus, and Packwood regarding the definition of wholesaler under the diesel fuel tax provisions and certain cooperative cardtrol/keytrol operations. See 134 Cong. Rec. S 15454-15455 (October 11, 1988).

diesel fuel to non-marine users, as long as the Treasury Department determines that no increased non-compliance will result.

(6) The conference agreement applies to fuel sold after December 31, 1988.

II. ADDITIONAL SIMPLIFICATION AND CLARIFICATION PROVISIONS

A. Sanction for Violation of Health Care Continuation Rules

Present Law

Certain group health plans are required to satisfy health care continuation rules (sec. 162(k) of the Code). In general, pursuant to these rules, an employer is required to provide qualified beneficiaries with the opportunity to participate for a specified period in the employer's health plan after the occurrence of a qualifying event that otherwise would have terminated such participation. If a plan subject to the health care continuation rules fails to satisfy the rules, all deductions for expenses paid or incurred for group health plans by the employer maintaining such plan are disallowed for the year in which the failure first occurs and all subsequent years up to and including the year in which the failure is corrected. In addition, the exclusion from income for employer-provided health coverage does not apply to the employer's highly compensated employees for the time of the failure to satisfy the health care continuation rules.

House Bill

In general

The House bill replaces the present-law sanctions for failures to satisfy the health care continuation rules with an excise tax.

Amount of excise tax

The amount of the excise tax is $100 per day during the noncompliance period with respect to a failure to satisfy the health care continuation rules. The tax applies separately with respect to each qualified beneficiary for whom a failure occurs.

Noncompliance period

The noncompliance period generally begins on the date a failure first occurs and ends on the earlier of (1) the date the failure is corrected, or (2) the date that is one year after the last date on which the employer could have been required to provide continuation coverage to the qualified beneficiary (without regard to payment of premiums). Subject to special rules described below, the noncompliance period does not start on the date the failure first occurred if it can be established that none of the persons who could be liable for the tax knew, or should have known, that the failure existed. In such a case, the noncompliance period does not begin until any of such persons knew or should have known of the failure. (This rule is referred to below as the inadvertent failure rule.)

Grace period

The excise tax generally does not apply to any failure if such failure was due to reasonable cause and not to willful neglect and the failure is corrected within the first 30 days of the noncompliance period.

Audit rule

A special audit rule overrides the inadvertent-failure and grace-period rules. Under the audit rule, if a failure with respect to a qualified beneficiary is not corrected by the date a notice of examination of income tax liability is sent to the employer and the failure occurred or continued during the period under examination, the excise tax is not to be less than the lesser of (1) $2,500, or (2) the excise tax determined without regard to the inadvertent-failure and grace-period rules. If failures for any year are more than de minimis with respect to the employer (or multiemployer plan in the case of coverage under such a plan), $15,000 is substituted for $2,500 for that year with respect to such employer (or multiemployer plan) and any other person liable with respect to the failure.

Correction

A failure to satisfy the continuation coverage rules is considered corrected if (1) the rules are retroactively satisfied to the extent possible, and (2) the qualified beneficiary (or his or her estate) is placed in a financial position that is as good as it would have been had the failure not occurred.

Maximum liability

In the case of failures with respect to plans other than multiemployer plans, the maximum excise tax for failures during an employer's taxable year is the lesser of (1) 10 percent of the total amount paid or incurred by the employer during the preceding taxable year for the employer's group health plans, or (2) $500,000. In the case of failures with respect to a multiemployer plan, the maximum excise tax for failures during the taxable year of the trust that is part of the plan is the lesser of (1) 10 percent of the total amount paid or incurred by the trust to provide medical care, or (2) $500,000. These caps on the amount of the excise tax do not apply if the failure is due to willful neglect.

Liable persons

In the case of a failure with respect to coverage provided by a plan other than a multiemployer plan, the employer is liable for the excise tax. In addition, any other person is liable for the tax if the person (1) is responsible for administering or providing benefits under the plan pursuant to a legally enforceable written agreement, and (2) failed to perform one or more of such responsibilities and thereby caused (in whole or in part) the failure. In addition, another person may be liable for the excise tax if the person fails to comply with a written request of the employer (or qualified beneficiary or plan administrator) to make available to qualified beneficiaries the same benefits that the person provides to similarly situated active employees. In the case of a multiemployer plan, the rules described above apply, except that "multiemployer plan" is substituted for "employer."

Waiver

In the case of a failure to comply with the continuation coverage rules that is due to reasonable cause and not to willful neglect, the Secretary may waive all or a part of the excise tax to the extent that the payment of the tax would be unduly burdensome relative to the failure involved.

Effective date

The House bill provisions are effective for taxable years beginning after December 31, 1988.

Senate Amendment

In general

The Senate amendment is the same as the House bill, with the exceptions noted below.

Amount of excise tax

The Senate amendment is the same as the House bill, except that if a failure occurs with respect to members of the same family, the excise tax applies only once with respect to the failure (i.e., the penalty is not greater than $100 a day).

Noncompliance period

The Senate amendment is the same as the House bill, except that the general noncompliance period begins on the date a failure first occurs and ends on the earlier of (1) the date the failure is corrected, or (2) the date that is the last date on which the employer could have been required to provide continuation coverage (without regard to payment of premiums).

Audit rule

The Senate amendment is the same as the House bill, except that if the excise tax is imposed on a person other than the employer (or multiemployer plan in the case of coverage under such a plan), only violations of the continuation coverage rules by such other person are taken into account in determining whether the violations are de minimis.

Liable persons

The Senate amendment is the same as the House bill, except that the Senate amendment does not contain the provision providing that persons are liable for the excise tax if they are responsible for administering or providing benefits under the plan pursuant to a written agreement.

Waiver

In the case of a failure to comply with the continuation coverage rules that is due to reasonable cause and not to willful neglect, the Secretary may waive all or part of the excise tax to the extent that the payment of the tax would be excessive relative to the failure involved.

Conference Agreement

The conference agreement follows the House bill, with the following exceptions.

Amount of excise tax

The conference agreement provides that the amount of the excise tax is $100 per day during the noncompliance period with respect to each qualified beneficiary. However, under the conference agreement, if a failure occurs with respect to more than one qualified beneficiary who are members of the same family, then the amount of the excise tax is no more than $200 per day for the failure with respect to such qualified beneficiaries in the same family.

Noncompliance period

Under the conference agreement, the noncompliance period ends on the earlier of (1) the date the failure is corrected, or (2) the date that is 6 months after the last date on which the employer could have been required to provide continuation coverage to the qualified beneficiary (without regard to payment of premiums).

Maximum liability

The conference agreement follows the House bill and the Senate amendment, except that the maximum excise tax for failures (not due to willful neglect) during a taxable year by a person other than an employer (or multiemployer plan in case of coverage under such a plan) is limited to $2 million.

Liable persons

The conference agreement follows the House bill with respect to the determination of who is liable for the excise tax, with the following clarifications. First, the conference agreement clarifies that the liability for the excise tax applies to a person if the person fails to "make continuation coverage available to" a qualified beneficiary, rather than if the person fails to "provide continuation coverage to" the qualified beneficiary.

As under the House bill, the conferees intend that a failure to make continuation coverage available does not automatically make a person liable for all other continuation coverage violations (such as a failure to provide written notice) without regard to the written agreement requirement. In other words, such a person is liable for a failure other than the failure to make continuation coverage available only pursuant to the written agreement provision. Also, as under the House bill, a person is not liable for the excise tax to the extent that an employer's act or failure to act made the person unable to comply with its responsibilities under the health care continuation rules.

The conference agreement clarifies the rule under which a person other than the employer is liable for the excise tax if such person fails to comply with a written request of a qualified beneficiary to make continuation coverage available to such qualified beneficiary. The conference agreement conforms the rule to the situations in which, under present law, the qualified beneficiary would provide notice to such person. Thus, under the conference agreement, liability may be triggered by a written request from a qualified beneficiary to a person other than the employer to provide continuation coverage only if such person is the plan administrator and the individual becomes a qualified beneficiary by reason of (1) the divorce or legal separation of the covered employee from the employee's spouse or (2) ceasing to be a dependent child under the generally applicable requirements of the plan. In all other cases, liability of a person other than the employer may be triggered only by a written request made by the employer or plan administrator.

Under the conference agreement, a person other than an employer (or multiemployer plan in the case of coverage under such a plan) is not liable for the excise tax for failure to make continuation coverage available pursuant to a written request until the date that is 45 days following the date that notice was provided to such person. The conferees anticipate that this rule will create an incentive for employers to provide adequate advance notice to a person (such as an insurance company) of the person's obligation to make continuation coverage available to qualified beneficiaries if such person had not previously been providing such coverage. For example, if the coverage was provided by another insurance carrier, or the employer self insured the coverage. The conferees do not intend this rule to relieve insurers, the employer, or other parties of their responsibility to provide continuation coverage during this 45-day period if they are so responsible. The provision is intended only to relieve third parties of liability for the excise tax for failure to make continuation coverage available in cases in which the employer fails to notify the third party of its responsibility to make continuation coverage available, but does not override a written agreement between the employer and the third party that the third party is to provide continuation coverage.

Waiver

The conference agreement follows the Senate amendment. As under the Senate amendment, the conferees intend that the determination of whether imposition of the excise tax would be excessive is to be made based on the seriousness of the failure and not on a particular taxpayer's ability to pay the tax.

B. Nondiscrimination Rules for Statutory Employee Benefit Plans

Overview

In general

Under present law, nondiscrimination rules apply to statutory employee benefit plans (sec. 89). The term "statutory employee benefit plans" includes accident or health plans and group-term life insurance plans. At the election of the employer, the term also includes qualified group legal services plans, educational assistance programs, and dependent care assistance programs.

Under the nondiscrimination rules, a plan generally is required to satisfy 3 eligibility tests (a 50-percent test, a 90-percent/50-percent test, and a nondiscriminatory provision test) and a benefits test. Alternatively, a plan may satisfy an 80-percent coverage test, provided it also satisfies the nondiscriminatory provision test.

Eligibility tests

50-percent test

Under the 50-percent test, nonhighly compensated employees must constitute at least 50 percent of the group of employees eligible to participate in the plan. This requirement is deemed to be satisfied if the percentage of highly compensated employees who are eligible to participate is not greater than the percentage of nonhighly compensated employees who are eligible to participate.

90-percent/50-percent test

A plan does not satisfy the 90-percent/50-percent test unless at least 90 percent of the employer's nonhighly compensated employees are eligible for a benefit that is at least 50 percent as valuable as the benefit available to the highly compensated employee to whom the most valuable benefit is available. For purposes of this test, all plans of the same type (i.e., all plans providing benefits excludable under the same Code section) are aggregated.

For purposes of this 90-percent/50-percent test, available elective contributions under a cafeteria plan are not taken into account.

Nondiscriminatory provision test

The third eligibility test provides that a plan may not contain any provision relating to eligibility to participate that by its terms or otherwise discriminates in favor of highly compensated employees. This third test is intended to disqualify arrangements only on the basis of discrimination that is not quantifiable.

Benefits test

The benefits test requires that the average employer-provided benefit received by nonhighly compensated employees under all plans of the employer of the same type (i.e., plans providing benefits excludable under the same Code section) be at least 75 percent of the average employer-provided benefit received by highly compensated employees under all plans of the employer of the same type.

Alternative 80-percent test

Present law also provides an alternative test that may be applied to accident or health plans and group-term life insurance plans in lieu of the eligibility and benefits tests described above. Under the alternative test, if a plan benefits at least 80 percent of an employer's nonhighly compensated employees, and the plan satisfies the nondiscriminatory provision test, the plan is considered to satisfy the nondiscrimination rules. For purposes of this alternative test, an individual is considered to benefit under a plan only if the individual receives coverage under the plan; eligibility to receive coverage is not considered benefiting under the plan. If the alternative

80-percent test is used, present law requires that this test be used by the employer in testing all plans of the same type (i.e., all plans providing benefits excludable under the same Code section).

Definitions

For purposes of applying the nondiscrimination rules to statutory employee benefit plans, present law provides generally applicable definitions of the following: (1) highly compensated employees (sec. 414(q)); (2) employer (sec. 414(b), (c), (m), (n), (o), and (t)); (3) line of business or operating unit (this definition is relevant if the employer elects to apply the nondiscrimination rules separately to separate lines of business or operating units of the employer) (sec. 414(r)); and (4) employees who are excluded from consideration. These definitions, other than the line of business or operating unit rule, apply generally to all employee benefit plans, not only to statutory employee benefit plans. The definitions of highly compensated employees, employer, and separate lines of business or operating units also generally apply for purposes of the qualified pension plan rules.

Effective date

In general, under the Reform Act, the employee benefit nondiscrimination rules of section 89 are effective for years beginning after the later of (1) December 31, 1987, or (2) the earlier of (a) the date that is 3 months after the date on which the Secretary issues regulations under section 89, or (b) December 31, 1988.

a. Treasury rules and good faith compliance

Present Law

Under present law, the Secretary is not directed to issue guidance with respect to the employee benefit nondiscrimination rules (sec. 89) by any specific date. In general, in the absence of guidance from the Secretary, taxpayers are permitted to make reasonable interpretations of the tax laws.

House Bill

Under the House bill, the Secretary is required to issue rules by October 1, 1988, providing guidance under section 89 on which employers may rely. Such guidance is to address those areas not addressed by the statute or legislative history and with respect to which employers need immediate guidance in order to comply with the nondiscrimination rules.

Until the issuance of rules by the Secretary, an employer's compliance with its reasonable interpretation of section 89 based on the statute and its legislative history, if made in good faith, constitutes compliance with section 89.

Senate Amendment

The Senate amendment modifies the House bill with respect to the issuance of rules by the Secretary by specifying that the rules are to include guidance with respect to the qualification requirements and the line of business or operating unit rules. The guidance with respect to the line of business or operating unit rules is to address the treatment of headquarters employees in a manner that facilitates administration of the rules within the expressed intent of the legislation.

The Senate amendment modifies the House bill by extending the good faith compliance standard to all provisions for which regulations were required by February 1, 1988, under section 1141 of the Tax Reform Act of 1986. Under this provision, if rules implementing a provision for which the good faith compliance standard is available before the effective date of the provision, the separate good faith standard does not apply.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the issuance of guidance by the Secretary, except that the Secretary is directed to issue guidance with respect to section 89 by November 15, 1988.

The conference agreement follows the Senate amendment with respect to the rules for which the good faith standard applies and follows the House bill with respect to the definition of what constitutes good faith compliance. Thus, under the conference agreement, a taxpayer will not be considered to be acting in good faith if such taxpayer consistently resolves unclear issues in his or her own favor.

In addition, the conference agreement clarifies that, pending the issuance of what the Secretary determines to be comprehensive section 89 rules on which taxpayers may rely, the good faith compliance provision will continue to apply to any issue not addressed by rules issued by the Secretary. When guidance is issued on any issue by the Secretary, the conferees do not intend the good faith compliance rule to apply to requirements that can reasonably be inferred from the rules issued by the Secretary.

b. Valuation

Present Law

The Secretary is to prescribe rules for determining the valuation of different benefits. With respect to health coverage, the Secretary is to establish tables prescribing the relative values of different types of health coverage.

House Bill

Under the House bill, any rules issued by the Secretary with respect to the valuation of accident or health coverage are effective as of the latest of (1) the first testing year beginning at least 6 months after issuance of such rules, (2) the first testing year beginning after December 31, 1990, or (3) the effective date specified by the Secretary for such rules. In addition, the House bill provides a temporary special valuation rule that applies prior to the effective date of rules issued by the Secretary.

Under the House bill, during and after the application of the temporary special valuation rule, in determining the benefits provided under a multiemployer plan, an employer generally may treat the contribution it makes to the plan on behalf of an employee as the benefit provided to the employee under such multiemployer plan. If the allocation of plan benefits between highly compensated employees and nonhighly compensated employees under the plan varies materially from the employer's allocation of plan contributions, the employer is to adopt a general method of eliminating such material variation through an appropriate adjustment to plan contributions.

This special rule for multiemployer plans does not apply to a multiemployer plan that covers any professional (e.g., a doctor, lawyer, or investment banker).

Senate Amendment

The Senate amendment generally follows the House bill, but modifies the House bill provision regarding the effective date of rules issued by the Secretary with respect to the valuation of accident or health coverage by requiring that such rules be effective no earlier than the first testing year beginning at least 1 year (rather than 6 months) after the issuance of such rules.

The Senate amendment also modifies the House bill with respect to the valuation of benefits provided under a multiemployer plan based on the employer contribution. The Senate amendment provides that the Secretary is to prescribe rules for the allocation of contributions that relate to benefits of different types. Under such rules, the allocation may be based on the prior year's claims or premiums, if this is reasonable under the circumstances.

Conference Agreement

The conference agreement follows the Senate amendment. The conferees intend that the delay in the effective date of valuation rules issued by the Secretary is not to apply to guidance provided under the temporary special valuation rule.

Under the special rule for multiemployer plans, the employer also is to adjust its contributions if the allocation of contributions within the group of highly compensated employees or nonhighly compensated employees varies materially from the allocation of plan benefits within such group. This could occur, for example, if an employer contributes the same amount with respect to each employee without regard to whether an employee has a family, but the plan benefit varies depending on whether an employee has a family.

Under the conference agreement, an employer contributing to a multiemployer plan is entitled to use the special valuation method only if that employer does not contribute to the plan on behalf of an employee who performs professional services. Thus, the determination of eligibility for the special valuation method is applied on a contributing employer by contributing employer basis. For purposes of this provision, professional services include the following services: legal, medical, engineering, architecture, actuarial science, financial, consulting, accounting, and such other services as the Secretary shall determine.

c. Time for testing

Present Law

Under present law, the nondiscrimination rules generally apply based on benefits available and provided during the entire plan year.

House Bill

Testing year

The House bill provides that an employer may designate a common 12-month period in its plans as the testing year for all or some of its plans even if such plans have different plan years and even if none of the plan years is the same as the common 12-month testing period. In the absence of a designation by the employer, the testing year is the plan year. A designation that is made may only be revoked with the consent of the Secretary.

Testing date

Under the House bill, the nondiscrimination rules are applied based on the benefits available and provided on one day in a year (the testing date). The employer may designate in the plan any day as the testing date. However, the testing date is required to be the same for all plans of the same type (except that two groups of plans may have two different dates if the two groups are in different lines of business or operating units that are tested separately under the nondiscrimination rules). If any plan does not specify a testing date, the testing date for all plans of the same type (subject to the line of business or operating unit exception) is the last day of any applicable testing year. For years beginning after December 31, 1989, a plan's designated testing date may not be changed without the consent of the Secretary.

Changes taken into account

Under the House bill, certain adjustments are required with respect to plans of the same type (i.e., plans providing benefits excludable under the same Code section) if there is a change in plan design or in any election by a highly compensated employee to change his or her benefits in any way during the year with respect to any such plan. Pursuant to these adjustments, such plan design changes and elections are required to be taken into account as of the testing date, but are to be prorated based on the period of time during which they were in effect during the year.

Senate Amendment

Testing year

The Senate amendment is the same as the House bill.

Testing date

The Senate amendment is the same as the House bill.

Changes taken into account

The Senate amendment treats certain changes as indirectly affecting the entire year under the nondiscrimination rules. Under the Senate amendment, for example, if during any part of the year an employer allowed certain employees to be eligible under a core health plan immediately upon being hired, then on the testing date and all determination dates, no employee may be disregarded in testing the employer's core health plans based on an initial service requirement (subject to the line of business or operating unit exception of sec. 89(h)(4)).

Conference Agreement

Testing year

The conference agreement generally follows the House bill and Senate amendment with respect to the rule that an employer may designate in its plans a common 12-month testing period. The conference agreement provides that the testing year is subject to the same consistency requirement that applies to the testing date (described below). That is, the testing year designated by the employer is required to be the same for all plans of the same type (except that plans of the same type may have different testing years if the plans are in different lines of business or operating units and the plans are being tested on a line of business or operating unit basis). If the employer does not designate a testing year in the plan or plans providing benefits of the same type have different designated years, then the testing year is the calendar year. Any designation of a testing period may not result in any period being disregarded for the purposes of section 89.

In addition, under the conference agreement, if a plan is maintained by more than one employer (whether a multiemployer or multiple employer plan), an employer maintaining the plan is not bound by the testing period, if any, designated in the plan. Each such employer may designate in writing, in a form not inconsistent with rules prescribed by the Secretary, the testing year it will use with respect to such plan. In the absence of such a designation by the employer, the general rules apply so that the employer tests the plan based on the testing year designated in the plan or, if no such year is designated, based on the calendar year.

Each employer's designation of a testing year is subject to the rules applicable to designations in a plan, including the requirement that the Secretary consent to changes of the testing year and that the testing year be the same for all plans of the same type.

Although a change in the testing year may be made with the consent of the Secretary, the conferees intend that any changes approved by the Secretary may not result in any period being disregarded for purposes of section 89. Further, as is the case with any designation of a testing year or testing date, such a change is subject to the nondiscriminatory provision test.

Testing date

The conference agreement follows the House bill and the Senate amendment. In addition, the conference agreement provides that, if a plan is maintained by more than one employer (whether a multiemployer or multiple employer plan), an employer maintaining the plan is not bound by the testing date, if any, designated in the plan. Each such employer may designate in writing, in a form not inconsistent with rules prescribed by the Secretary, the testing date it will use with respect to such plan.

In the absence of such a designation by the employer, the general rules apply so that the employer tests the plan based on the testing date designated in the plan (if consistent with the testing date for other plans of the employer of the same type) or, if no date is designated or there are no other plans of the same type of the employer, based on the last day of the applicable testing year.

The rules generally applicable to testing dates apply for purposes of this special rule. Thus, the testing date is to be the same for all plans of the same type (subject to the separate line of business and operating unit exception), and, for years beginning after 1989, the designation may be changed only with the consent of the Treasury.

The conferees intend that the designation of an annual testing date need not be of a certain date, such as January 1 of each testing year. The designation also may be made by use of a fixed method, such as the last day of the first two-week pay period ending in the testing year.

Changes taken into account

The conference agreement follows the Senate amendment, but clarifies that the rule in the Senate amendment relating to the disregard of employees is subject not only to the line of business or operating unit exception, but also to the separate testing rule (sec. 89(h)(5)) and to the special multiemployer plan rule (new sec. 89(h)(6)).

The conferees intend that changes in plan design and highly compensated employee elections that occur prior to the testing date but within the same testing year are to be taken into account, just as such changes and elections are required to be taken into account if they occur after the testing date but within the same testing year.

Determination of discriminatory excess

The conferees clarify the interaction of the annual testing procedure and the determination of the discriminatory excess with the following example.

Assume that an employer uses the calendar year as its testing year and January 1 as its testing date. Assume further that all of the employer's accident and health plans satisfy the 50-percent test, the 90-percent/50-percent test, and the nondiscriminatory provision test. Assume that the employer elects to test employee coverage and coverage of spouses and dependents together for purposes of the 75-percent test.

Example 1.—Assume that for 1990, the following facts exist (see Example 1):

EXAMPLE 1.—DETERMINATION OF DISCRIMINATORY EXCESS

Employee	Employment during 1990	Employer provided benefit	Testing value
A	1/1–6/30	$500	$1,000
B	1/1–12/31	1,000	1,000
C	1/1–12/31	1,500	1,500
D	2/1–12/31	1,375	NA
E (highly compensated)	1/1–6/30	900	1,800
F (highly compensated)	1/1–12/31	1,800	1,800
G (highly compensated)	2/1–12/31	917	NA

Assume further that there are no changes in plan design or changes in highly compensated employees' elections during 1990.

The employer-provided benefit column provides the actual employer-provided benefit received by each employee during 1990. The testing value column provides the annual value of the employer-provided benefit that each employee receives on the testing date. This testing value is determined by taking into account the actual employer-provided benefit for each employee who is employed on the testing date, but adjusting such benefit to the value of the benefit as if it were provided for the entire testing year. It is this value that is used for purposes of applying the 75-percent test. There are no testing values for D and G because they are not employed on the testing date and thus are disregarded for testing purposes.

Based on these facts, for purposes of the 75-percent benefits test, the average employer-provided benefit for the nonhighly compensated employees is $1,167 (($1,000 + $1,000 + $1,500) / 3). The average employer-provided benefit for the highly compensated employees is $1,800 (($1,800 + $1,800)/2). In order to satisfy the 75-percent test, the average employer-provided benefit may not exceed $1,556 ($1,167/.75). Thus, there is a discriminatory excess under the 75-percent test.

Once an employer determines that there is a discriminatory excess under the plan, the employer is required to determine the actual employer-provided benefit for every highly compensated employee, including those not employed on the testing date, and apply the tests based on such data. This calculation may result in an increase or decrease or even an elimination of the discriminatory excess. The average employer-provided benefit for nonhighly compensated employees is not recalculated.

For example, under the above facts, the average employer-provided benefit for the highly compensated employees is $1,497. This is determined under the present-law rules applicable for purposes of the 75-percent test, i.e., by including the actual employer-provided benefit in the numerator and counting an employee as less than a full employee in the denominator if such employee is not employed for the entire year. In this example, E is 1/2 of an employee and G is 11/12 of an employee. Thus, the average employer-provided benefit for the highly compensated employees is calculated as follows: ($900 + $1,800 + $917)/ (1 + 1/2 + 11/12) = $1,497. Because $1,497 is less than $1,556, there is no discriminatory excess under the 75-percent test.

Assume, however, that G's actual employer-provided benefit is $1,650, rather than $917. In this case, the average employer-provided benefit (based on actual data) for the highly compensated employees is $1,800. This amount is calculated as follows: ($900 + $1,800 + $ $1,650)/(1+ 1/2 + 11/12) = $1,800. Because $1,800 is above the maximum permitted average for the highly compensated employees of $1,556, there is a discriminatory excess, and it is necessary to allocate the excess among the highly compensated employees.

As under present law, the discriminatory excess is defined as the amount of the otherwise nontaxable employer-provided benefit (including any benefits purchased with elective contributions) that would have to have been purchased with after-tax employee contributions by the highly compensated employees in order to satisfy all the nondiscrimination tests. Any discriminatory excess with respect to the benefits test is to be allocated to highly compensated employees by reducing the otherwise nontaxable employer-provided benefit (including benefits purchased with elective contributions) of highly compensated employees, beginning with the employees with the greatest such benefit, until the plan (or plans) being tested would not be discriminatory under the benefits test.

The amount of the discriminatory excess is determined and allocated as follows. First, the total discriminatory excess for all highly compensated employees is determined by (1) calculating what the total employer-provided benefit for all highly compensated employees would be if the average employer-provided benefit for such employees satisfied the benefits test, and then (2) subtracting the amount in (1) from the total actual employer-provided benefit for all highly compensated employees.

In the example, the calculation of the total permitted employer-provided benefit for highly compensated employees is $1,556 x (1 + 1/2 + 11/12) = $3,760. Then, this amount is subtracted from the actual employer-provided benefit for the highly compensated employees to obtain the total excess of $590 as follows: ($900 + $1,800 + $1,600) − $3,760 = $590.

To allocate the $590 of discriminatory excess among the highly compensated employees, F's benefit is reduced first, because F has the highest employer-provided benefit. Thus, F's otherwise nontaxable employer-provided benefit is reduced by $150, to the level of G's employer-provided benefit. Then, F's and G's benefits are reduced equally until the remaining $440 of excess ($590 − $150) is allocated. That is, F's benefit is reduced by an additional $220, and G's benefit is reduced by $220. Thus, F's total nontaxable benefit is $1,430 ($1,800 − $150 − $220), as is G's ($1,650 − $220). A total of $370 ($150 + $220) is includible in F's income, and a total of $220 is includible in G's income.

d. Sampling

Present Law

Under present law, employers are required to demonstrate compliance with the employee benefit nondiscrimination rules based on data with respect to all of their employees.

House Bill

Under the House bill, employers are entitled to determine whether a plan is discriminatory on the basis of a statistically valid random sample of employees that is not inconsistent with rules prescribed by the Secretary. Such random sampling may be performed only by an independent third party. For this purpose, sampling is treated as valid only if the statistical method and sample size produce a 99 percent level of confidence that the sample results have a margin of error not greater than two percent.

Sampling may be used only for purposes of testing whether a plan is discriminatory. It may not be used for purposes of identifying the highly compensated employees who have a discriminatory excess or the amount of such excess.

Senate Amendment

Under the Senate amendment, the sampling rules of the House bill are modified by providing that sampling is treated as valid if the statistical method and sample size produce a 95-percent level of confidence that the sample results have a margin of error not greater than three percent.

Conference Agreement

The conference agreement follows the Senate amendment. As under the Senate amendment, employers may rely on sampling in determining the benefits available to or provided to nonhighly compensated employees for testing purposes. However, if an employer determines through sampling that its plans are discriminatory, the employer is to collect data with respect to all highly compensated employees and apply the tests based on the more complete data (still using the sampling results for the nonhighly compensated employees).

e. Comparability

Present Law

General comparability range

Under present law, for purposes of applying the 80-percent test to accident and health plans, in general, a group of plans are comparable and may be aggregated as one plan if the least valuable plan has a value of at least 95 percent of the value of the most valuable plan.

Plans outside general comparability range

Under present law, for purposes of the 80-percent benefits test, a plan (or group of comparable plans) with a value greater than the value permitted under the general comparability rule may be aggregated with the group of less valuable plans if the percentage of highly compensated employees actually covered under the plan does not exceed the percentage of nonhighly compensated employees actually covered.

House Bill

General comparability range

Under the House bill, for purposes of the 80-percent test, an employer may elect to reduce the 95-percent comparability standard to an 80-percent standard. However, in any testing year for which the election is made, the 80-percent benefits test is modified to be a 90-percent test. (References below to the 80-percent test generally include this alternative 80-percent comparability, 90-percent benefits test.)

Plans outside general comparability range

Under the House bill, for purposes of the 80-percent benefits test, a plan (or group of comparable plans) with a value greater than the value permitted under the general comparability rule may be aggregated with the group of less valuable plans if the percentage of nonhighly compensated employees actually covered is at least 80 percent (90 percent if the 80-percent comparability standard is elected) of the percentage of highly compensated employees actually covered.

Senate Amendment

General comparability range

The Senate amendment is the same as the House bill, except that the general comparability standard for the 80-percent test is modified by substituting 90 percent for 95 percent.

In addition, an employer may elect to reduce the 90-percent requirement for comparability to 80 percent. However, in any testing year for which such an election is made, the 80-percent benefits test is modified to be a 90-percent test.

Plans outside the general comparability range

The Senate amendment is the same as the House bill.

Comparability safe harbor

Under the Senate amendment, for purposes of the 80-percent test, two or more accident or health plans may be treated as comparable with respect to a group of employees if:

(1) such plans are available to all employees within the group on the same terms; and

(2) the difference in annual cost to the employees between the plan in the group with the smallest employee cost and the plan in the group with the largest employee cost is no more than $100 (indexed beginning in 1990 for increases in the consumer price index).

For purposes of the $100 allowable cost differential, employee contributions may be compared only with other employee contributions made on the same basis (e.g., after-tax as opposed to pre-tax). If the employer elects to test coverage of employees separately from coverage of spouses and dependents, the $100 allowable cost differential may be allocated between coverage of employees and coverage of spouses and dependents in any way elected by the employer (e.g., $40 differential taken into account for employee coverage and $60 differential taken into account for coverage of spouses and dependents).

The Senate amendment also provides that plans that do not meet the safe harbor may be aggregated with plans satisfying the safe harbor in two circumstances.

First, any other plan may be aggregated with the group of plans described above if such other plan is comparable (under the otherwise applicable comparability standard) to the plan within the group with the largest employer-provided benefit.

Second, a plan also may be treated as comparable to the group of plans satisfying the comparability safe harbor with respect to an employee if (1) the employee is eligible under the plan within the group with the largest employer-provided benefit, (2) the contribution under the plan outside the group is within the range permitted with respect to the group of plans, and (3) the employer-provided benefit under the plan outside of the group is less than the employer-provided benefit under the plan within the group with the largest such benefit. The first two requirements only apply to nonhighly compensated employees. This rule permits, for example, a plan that is available to highly compensated employees and that has a lower employer-provided benefit and an employee cost within the range permitted by the safe harbor to be aggregated with the group of plans aggregated under the comparability safe harbor.

Conference Agreement

General comparability range

The conference agreement follows the Senate amendment.

Plans outside general comparability range

The conference agreement follows the House bill and the Senate amendment.

Comparability safe harbor

The conference agreement follows the Senate amendment. This special safe harbor differs from the present-law general comparability standard in that the present-law rule looks at the employer-provided benefit, whereas the safe harbor looks at the cost to the employee (i.e., the employee contributions) of the plan. The theory of the safe harbor is that, if an employee may choose freely among different benefit plans, then an employee will choose a plan based on the benefits provided, rather than based on other factors, such as cost, so that the plans should be considered comparable.

The theory of the safe harbor rule argues for a safe harbor rule that allows aggregation of plans only if there is no difference in employee cost. In other words, an employee has the greatest degree of free choice if the cost to the employee of each plan is the same. The conferees believe, however, that some flexibility in the cost differential is appropriate to ease the administrative burdens of complying with the employee benefit nondiscrimination requirements. The conference agreement does not permit any greater cost differential to be taken into account because such a greater differential could seriously erode the intent of the nondiscrimination rules and would be inconsistent with the concept of free choice.

The conference agreement modifies the safe harbor by providing that a plan may be treated as comparable to the group of plans satisfying the safe harbor with respect to an employee if (1) the plan has a lower employer-provided benefit than the plan in the group with the highest employer-provided benefit, (2) with respect to a nonhighly compensated employee, the employee is eligible for the plan within the group with the highest employer-provided benefit, and (3) with respect to a nonhighly compensated employee, the employee contribution required under the plan is not less than the smallest employee contribution permitted under the safe harbor. This rule permits, for example, a plan with a higher employee contribution but a lower employer-provided benefit to be aggregated with the group of plans as long as the employee is eligible for the best plan in the group. An employee might choose the plan outside the group, for example, if it provides family coverage, and the plans within the group do not.

Summary of comparability rules

The comparability rules of the conference agreement applicable to the 80-percent test in the case of accident or health plans are summarized and illustrated below. Of course, under present law, if the 80-percent test is used by the employer, it is to be used with respect to all plans of the employer of the same type.

(1) *General comparability range.*—For purposes of the 80-percent test, a group of plans are comparable and may be aggregated if the value of the employer-provided coverage provided to each covered employee in the plan with the lowest such value is at least 90 percent of the value of the employer-provided coverage provided to each covered employee in the plan with the highest such value. The comparability standard is reduced to 80 percent if the employer elects to apply the 80-percent test as a 90-percent test.

(2) *Plans outside the general comparability range.*—For purposes of the 80 percent test, a plan with a value greater than that permitted under the general comparability rule may be aggregated with a group of less valuable comparable plans if the percentage of nonhighly compensated employees covered under the plan with the greater value is at least 80 percent (90 percent if the 80-percent test is applied as a 90-percent test) of the percentage of highly compensated employees covered under such plan.

(3) *Comparability safe harbor.*—

(a) Under the general safe harbor rule, as described more fully above, for purposes of the 80-percent test, a group of plans is treated as comparable with respect to a group of employees if (i) such plans are available on the same terms to all employees within the group, and (ii) the difference in annual cost to the employees between the plan in the group with the smallest employee cost and the plan with the highest employee cost is not more than $100 (indexed).

(b) Any other plan may be aggregated with the group of plans in (a) if such other plan is comparable (under the general comparability range described in paragraph (1) above) to the plan within the group with the largest employer-provided benefit.

(c) A plan may also be treated as comparable to the group of plans described in (a) and (b) with respect to an employee if (i) in the case of a nonhighly compensated employee, such employee is eligible under the plan within the group with the largest employer-provided benefit, (ii) in the case of a nonhighly compensated employee, the employee contribution under the plan outside the group is not less than the smallest employee contribution permitted with respect to the group of plans under the general safe harbor, and (iii) the employer-provided benefit under the plan outside of the group is less than the employer-provided benefit under the plan within the group with the largest such benefit (without taking into account any plans aggregated under (b) above).

The comparability rules do not override the rule requiring plans to be aggregated in certain cases. (See discussion below with respect to mandatory aggregation.)

Example 2.—The following example illustrates the application of the comparability rules for plans outside the general comparability range.

Assume, for example, that in testing year 1989, an employer maintains indemnity health plans that vary only with respect to the deductibles and required employee contributions. The total coverage is the same under all the plans. The deductibles and required employee contributions are as follows:

EXAMPLE 2.—PERMISSIBLE AGGREGATION—ACCIDENT OR HEALTH PLANS

Plan (employee coverage)	Plan (family coverage)	Compensation [1]	Employee deductible	Employee and family deductible	Employee contribution (employee only)	Employee contribution (employee and family)
A	A1	0 to $19,999	$100	$250	0	0
B	B1	$20,000 to $39,000	150	375	$50	$125
C	C1	$40,000 to $59,999	200	500	100	250
D	D1	$60,000 to $79,999	250	625	150	375
E	E1	$80,000 to $99,999	300	750	200	500
F	F1	$100,000 and higher	350	857	250	625

[1] The definition of compensation for this purpose is the same as the 1 used under sec. 414(q)(7).

There are 12 plans described in the above chart. Plan A is employee coverage for employees earning between $0 and $19,999; Plan A1 is coverage of spouses and dependents of employees in the same compensation range. Thus, there are two plans in each compensation range and six compensation ranges for a total of 12 plans.

Assume that these 12 plans are the only plans maintained by this employer. Assume further that the employer elects to test employee coverage and coverage of spouses and dependents separately, and, with respect to the latter, elects to disregard employees who do not have a spouse or dependent.

Assume that, with respect to this employer, highly compensated employees are employees with compensation (as defined in sec. 414(q)(7)) in excess of $50,000. Thus, Plans A and B cover only nonhighly compensated employees, Plan C covers both highly and nonhighly compensated employees, and Plans D, E, and F cover only highly compensated employees.

It is assumed for purposes of this example that the employer does not disregard individuals covered under another employer's core health plan. It also is assumed that the nondiscriminatory provision test is satisfied.

Under the aggregation rule for plans outside the general comparability range, all employee coverage is nondiscriminatory under the 80-percent test if 80 percent of the nonhighly compensated employees are covered under one of the plans providing employee coverage. In addition, all coverage of spouses and dependents is nondiscriminatory under the 80-percent test if 80 percent of the nonhighly compensated employees with families are covered under one of the plans providing coverage of spouses and dependents. This result is obtained through successive application of the rule for aggregating plans outside the general comparability range, as described below. For convenience, the following discussion refers only to employee coverage.

Under this example, because the only differences between the plans are the deductibles and required employee contributions, it is clear that the employer-provided benefit is the greatest under Plan A and is less under each succeeding plan with the smallest employer-provided benefit provided under Plan F. With that as an initial conclusion, it is clear that Plans A and B be aggregated because Plan A consists solely of nonhighly compensated employees and, thus, even if Plan A is above the permitted comparability range with respect to Plan B, under the rule for plans above the comparability range, Plan A may be aggregated with a less valuable plan.

Plans A and B can be aggregated with Plan C for the same reason. Thus, Plans A, B, and C, which are the only plans with nonhighly compensated employees, may be aggregated.

Under the rule for plans outside the comparability range, the group consisting of Plans A, B, and C can be aggregated with Plan D even if such plans are outside the comparability range with respect to Plan D if the percentage of nonhighly compensated employees participating in Plans A, B, and C is at least 80 percent of the percentage of highly compensated employees participating in such plans. This requirement will be automatically satisfied if at least 80 percent of all nonhighly compensated employees of the employer participate in Plans A, B, or C (Plan D by definition does not cover nonhighly compensated employees). Assuming that is the case, then Plans A, B, and C can be aggregated with Plan D. Under the same analysis, Plan E may be aggregated with Plans A, B, C, and D, and Plan F may be aggregated with Plans A, B, C, D, and E.

Assume the same facts described above, except that the required employee contributions are paid by all employees with pre-tax dollars through salary reduction under a cafeteria plan. The result would be the same, even though benefits funded through salary reduction are employer-provided benefits for purposes of the 80-percent test. The result occurs because it can be determined without valuation that the higher paid employees have smaller employer-provided benefits. The use of salary reduction to pay the required employee contributions reduces this disparity but does not eliminate it because the deductibles still rise with compensation.

Assume the same facts described above, except that the required employee contributions are paid with after-tax dollars. Assume further that each employee may choose between plans A to F, whichever is applicable, and a health maintenance organization (HMO).

If the employee elects the HMO, the employer contributes the same amount to the HMO that it would contribute to the indemnity plan on behalf of the employee (determined without regard to the age or any other characteristic of the employee). In such a situation, the HMOs may be aggregated with the indemnity plans for purposes of satisfying the 80-percent test if: (1) the employer elects to use cost as its valuation method under the temporary special valuation method; and (2) each HMO has a cost equal to at least 90 percent of the employer cost for the corresponding indemnity plan. (It may be that the HMOs may be aggregated with the indemnity plans even if the employer does not use cost as its valuation method (which must be the same for all plans tested together), but this would depend on facts not described above, i.e., the noncost values of the HMOs and indemnity plans.)

Example 3.—This example demonstrates the comparability safe harbor rule. Assume an employer maintains three plans, Plans A, B, and C, with the following required employee contributions and employer-provided coverage. Assume further that all three plans are available to all nonhighly compensated employees of the employer.

EXAMPLE 3.—COMPARABILITY SAFE HARBOR

	Plan					
	A	B	C	D	E	F
Employee contribution	$100	$50	0	$150	$50	$150
Value of employer-provided benefit	1,000	900	800	900	700	800

Plans A, B, and C, may be aggregated under the safe harbor with respect to all employees to whom the plans are available, because the plans have a difference in employee contributions of no more than $100.

Assume that the employer also maintains Plan D. Plan D can not be aggregated with plans A, B, and C under the general safe harbor rule because the required contribution is outside the permissible range. However, Plan D can be aggregated with plans A, B, and C under the rule that a plan that is comparable to a plan within the safe harbor group with the largest employer-provided benefit (Plan A) may be aggregated with the group.

Assume further that the employer also maintains Plan E. Assume further that Plan E is not available to all the employees who are eligible for Plans A, B, and C, but that all employees eligible for Plan E are eligible for Plan A. Because of this eligibility restriction, Plan E cannot be aggregated with Plans A, B, and C under the general safe harbor. However, Plan E can be aggregated with Plans A, B, and C under the rule (described in paragraph (3)(c) above) that a plan can be aggregated with plans in the safe harbor group if nonhighly compensated employees are eligible under the plan in the group with the largest employer-provided benefit, if the contributions of nonhighly compensated employees are within the range of employee contributions permitted for the safe harbor group, and the employer-provided benefit for the plan outside the safe harbor group is smaller than the largest employer-provided benefit under a plan within the group. (Even if not all the nonhighly compensated employees who are eligible for Plan E are eligible for Plan A, the aggregation rule applies with respect to those nonhighly compensated employees who are eligible for Plan A.)

Assume that the employer also maintains Plan F, and that all employees eligible for Plan F are eligible for Plan A. Plan F can be aggregated with Plans A, B, and C under the same rule (described in paragraph (3)(c) above) under which Plan E may be aggregated. (Even if not all the nonhighly compensated employees who are eligible for Plan F are eligible for Plan A, the aggregation rule applies with respect to those nonhighly compensated employees who are eligible for Plan A.)

f. Permissive plan aggregation

Present Law

Under present law, in applying the 75-percent benefits test to plans other than accident or health plans (but not in applying the test to accident or health plans), the employer may aggregate with such plans all plans of one or more different types (i.e., plans providing benefits excludable under one or more different Code sections). Thus, all accident or health plans may be aggregated with plans of a different type to help the nonaccident or health plans satisfy the 75-percent test, but not to help the accident or health plans satisfy such test.

House Bill

No provision.

Senate Amendment

The Senate amendment liberalizes in two respects an employer's ability to aggregate plans of different types for purposes of the 75-percent benefits test. First, the Senate amendment allows benefits of one or more types to be aggregated with all accident or health benefits in order to help the accident or health benefits satisfy the 75-percent benefits test.

Second, under the Senate amendment, an employer may aggregate accident and health benefits with benefits of a different type for purposes of the 75-percent benefits test even if the employer elects to apply the 75-percent benefits test separately to coverage of employees and coverage of employees' spouses and dependents.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the rule allowing benefits to be aggregated even if the 75-percent test is applied separately to accident and health benefits of employees and accident and health benefits of employees' spouses and dependents, and follows the House bill with respect to the rule that employers may aggregate plans other than accident or health plans with accident or health plans to help the accident or health plans satisfy the 75-percent benefits test. Thus, as under present law, plans other than accident or health plans may not be aggregated with accident or health plans to help the accident or health plans satisfy the test.

g. Mandatory plan aggregation—accident or health plans

Present Law

Under present law, each different option with respect to employee benefits generally is treated as a separate plan for testing purposes. However, for purposes of the 50-percent eligibility test and the 80-percent alternative benefits test, comparable accident or health plans may be aggregated (sec. 89)(g)(1)).

House Bill

The House bill provides that, under rules prescribed by the Secretary, if an employee is eligible for (in the case of the 50-percent test) or receives coverage (in the case of the 80-percent test) under more than one accident or health plan, then, for purposes of the 50-percent test and the 80-percent test, such plans are required to be considered one plan with respect to such employee.

For example, assume that an employer maintains two plans: two benefiting all employees with a value of $950, and a second benefiting only highly compensated employees with a value of $1,000. Thus, highly compensated employees receiving benefits from both plans are to be treated for purposes of the 50-percent test and the 80-percent test as receiving $1,950 of benefits from one plan while the nonhighly compensated employees are to be treated as receiving $950 of benefits from a separate plan.

This rule, requiring certain plans to be treated as 1 plan with respect to certain employees, supersedes the rule of present law allowing employers to structure options in different ways as long as all coverage within a plan is identical.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment.

h. Other coverage and sworn statements

Present Law

For purposes of applying the 75-percent benefits test to accident or health plans, an employer generally may elect to disregard any employee or family member of an employee if such individual is covered by a health plan that provides core benefits and that is maintained by another employer of the employee or of the employee's spouse or dependent. For purposes of the same test, if the employer elects to test separately the coverage of spouses and dependents, the employer may disregard employees who do not have a spouse or dependent.

In general, an employer who elects either of these optional rules is required annually to obtain and maintain adequate sworn statements on an IRS form to demonstrate whether individuals have core health coverage from another employer and whether employees have families. Present law permits employers to secure the sworn statements from a statistically valid sample of all employees.

For purposes of the 80-percent alternative benefits test, employees or family members who have coverage under another plan may not be disregarded.

House Bill

Other coverage

Under the House bill, an individual may be disregarded based on core health coverage received from another employer of any family member, including a parent. However, under the House bill, a highly compensated employee (or his or her family) may not be disregarded nor may coverage provided to such highly compensated employee (or his or her family) be disregarded if the coverage provided to such highly compensated employee (or his or her family) is provided under a plan that is aggregated under the special comparability rule for plans outside the normal comparability range.

In addition, with respect to testing accident or health coverage, the 80-percent benefits test is modified to have two parts: (1) the present-law 80-percent coverage requirement with the "other coverage" rule described above, and (2) a requirement that the plan be available to 80 percent (90 percent if the employer elects to reduce the standard for comparability of plans as otherwise permitted by the bill) of the employer's nonhighly compensated employees.

Sworn statements

Under the House bill, the present-law rule governing the form sworn statements are to take is modified to (1) eliminate the requirement that the statements be on an IRS form; and (2) direct the IRS to supply language for inclusion on appropriate employer documents (such as enrollment forms). Under the House bill, after initial enrollment, the sworn statements are required to be collected no more frequently than once every three years unless an employee makes an election with respect to an employee benefit program (including an election not to participate). For years beginning after 1989, the sworn statements generally are required to relate to the facts in existence on the plan's testing date.

Under the House bill, no nonhighly compensated employee (or family member) may be disregarded based on the receipt of other core health coverage unless the employee has the right, if such other coverage ceases, to elect health coverage from the employer without regard to whether it is otherwise open season. For all purposes, such election is to be on the same terms as if such employee had initially elected health coverage from the employer and at a subsequent open season was changing such coverage. A similar rule applies in the case of the treatment of an employee as not having a family. These modifications apply to years beginning after December 31, 1989.

Under the House bill, an employer ("first employer") may treat an individual as having core health coverage from another employer without securing a sworn statement if (1) the first employer makes core health coverage available to the individual at no cost, and (2) such core coverage is rejected by the employee.

Senate Amendment

Other coverage

The Senate amendment is the same as the House bill.

Sworn statements

The Senate amendment generally is the same as the House bill. However, under the Senate amendment, the right of an employee to elect health coverage from the employer without regard to whether it is open season is to be on the same terms as if the employee initially had opted out of health coverage (individual coverage or coverage of his or her spouse and dependents, as the case may be) and was electing coverage at a subsequent open season. Thus, if the employer generally requires such employees to demonstrate evidence of insurability at open season, the employer may do so under this special rule. Also, the coverages required to be made available to the employee are those, if any, that would be available during open season to a similarly situated employee.

The Senate amendment also authorizes the Secretary to prescribe additional rules to make the collection of sworn statements more administrable and the information collected more reliable.

Conference Agreement

Other coverage

The conference agreement follows the House bill and Senate amendment.

Sworn statements

The conference agreement generally follows the Senate amendment. In addition, under the conference agreement, the triennial collection of sworn statements need not relate to the facts in existence on the annual testing date. The collection may relate to the facts in existence on any date (collection fact date) within 6 months of the actual collection. However, with respect to any testing date, the collection of sworn statements that is to be used in testing the plan for nondiscrimination is the one with the collection fact date that is closest in time to the testing date, provided that such collection fact date precedes the testing date.

The conference agreement also clarifies the "open-season" rule under the Senate amendment. Under the open-season rule, with respect to accident or health plans, generally no nonhighly compensated employee (or family member) may be disregarded for purposes of the 75-percent benefits test or the 80-percent alternative benefits test based on his or her receipt of other core health coverage unless, under the plans, the employee has the right to elect and receive health coverage from the employer as if it were open season if such other coverage ceases. A similar rule applies in the case of an employee who is treated as not having a family and then has a family. The conferees intend that, if an employee is in a class that is ineligible for one or more accident or health plans, such employee may be disregarded based on other coverage or on not having a family despite the fact that if such employee lost the other coverage or acquired a family, he or she would not be eligible for such plan or plans.

The conference agreement provides that the sworn statements are to include the coverage the individual is receiving, as well as information as to family status and other coverage. Such information is necessary, for example, to prevent the inappropriate consideration of individuals who have other coverage and who also elect coverage under the employer's plan, and to avoid the failure to take into account individuals who do not have coverage elsewhere but nevertheless do not elect coverage under a plan of the employer.

i. Family coverage

Present Law

Under present law, a special rule applies in the case of family coverage under an accident or health plan. Pursuant to this special rule, for purposes of the 90-percent/50-percent eligibility test and the 80-percent benefits test, the coverage for employees and the coverage for spouses and dependents may be tested separately, as if they constituted two different types of plans. Further, for purposes of the same test, with respect to coverage of spouses and dependents, the employer may disregard employees who do not have a spouse or dependent. An employer who elects this latter optional rule is required to obtain and maintain adequate sworn statements on an IRS form to demonstrate whether employees have a spouse or dependent.

House Bill

The House bill deletes the rule allowing employers to apply the 90-percent/50-percent eligibility test separately with respect to family coverage and to take into account for such purpose only employees who have a family.

Under the House bill, family coverage (i.e., coverage of an employee's family, which is considered separate from coverage of the employee) may be considered to be available (if otherwise available) or provided (if otherwise provided) to an employee despite the fact that the employee does not have a family.

This rule alone, however, could produce inappropriate results in certain circumstances, and it is intended that the nondiscriminatory provision test will be applied to prevent such results.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment, but clarifies that if an employee is entitled to coverage of his or her spouse or dependents under the terms of an accident or health plan, such employee is considered to receive such coverage despite the fact that such employee may not have a spouse or dependents. Thus, for example, if coverage of an employee's spouse and dependents is noncontributory and the employee does not reject the coverage, such employee is considered to receive coverage of his or her spouse and dependents without regard to whether he or she has a spouse or dependents. If coverage of an employee's spouse and dependents is contributory and the employee makes the required contribution, such employee is considered to receive coverage for his or her spouse and dependents without regard to whether he or she has a spouse or dependents. Of course, in such case, if the employee does not make the required contribution, the employee is not considered to receive coverage for his or her spouse and dependents (if any).

j. Cafeteria plans

Present Law

Definition of a cafeteria plan

Under present law, the definition of a cafeteria plan includes a plan only offering a choice between nontaxable benefits (sec. 125).

Qualified benefits

To qualify as a cafeteria plan, a plan may not offer benefits other than cash and qualified benefits. The term "qualified benefit" generally means any benefit that, with the application of section 125(a), is excludable from an employee's income by reason of a provision of Chapter 1 of the Code (other than secs. 117, 124, 127, or 132). In addition, the term includes (1) any group-term life insurance coverage that is includible in income only because it is in excess of $50,000, and (2) any other benefit permitted under regulations.

Election limitations

Under present law, employers are allowed to limit the elections of highly compensated employees under a cafeteria plan to the extent necessary to comply with the applicable nondiscrimination rules (e.g., sec. 89 or sec. 129(c)(7)). However, these limitations are to be applied in the manner prescribed for allocating discriminatory excess among highly compensated employees.

Excludable employees

Employees who may be disregarded for purposes of the nondiscrimination rules (sec. 89(h)) may also be disregarded for purposes of applying the cafeteria plan nondiscrimination rule (sec. 125(b)(1)) to any cafeteria plan. An employee in a particular category (e.g., an employee who does not meet a minimum age or service requirement) may be disregarded only if all employees in that category are ineligible under all plans of the same type (sec. 89(h)(3)(A)). In the case of a cafeteria plan, all benefits under the cafeteria plan are treated as provided under plans of the same type.

House Bill

Definition of a cafeteria plan

The House bill amends the definition of a cafeteria plan so that a choice only between nontaxable benefits is not a cafeteria plan.

Sanctions

The House bill clarifies that, in the case of a cafeteria plan that fails the cafeteria plan nondiscrimination test (sec. 125(b)(1)), only highly compensated employees are required to include the available taxable benefits in income. In the case of a cafeteria plan that fails the key employee concentration test (sec. 125(b)(2)), the House bill clarifies that only key employees are required to include the available taxable benefits in income.

Qualified benefits

The House bill modifies the definition of qualified benefits to include benefits that would be qualified benefits but for the fact that they are includible in an employee's income because of a failure to satisfy the nondiscrimination requirements (sec. 89(a)). Thus, if, for example, there is a discriminatory excess with respect to a health plan offered under a cafeteria plan, such discriminatory excess will not cause the cafeteria plan to cease to be a cafeteria plan.

Senate Amendment

Definition of a cafeteria plan

The Senate amendment is the same as the House bill.

Sanctions

The Senate amendment is the same as the House bill.

Qualified benefits

The Senate amendment is the same as the House bill.

Election limitations

Under the Senate amendment, the limits on elections of highly compensated employees may be applied in any manner used consistently by the employer that precludes employer discretion during the year in which the limitation applies. For years beginning after December 31, 1989, such nondiscretionary method is required to be established in the plan document prior to the beginning of the year to which the method applies.

Conference Agreement

Definition of a cafeteria plan

The conference agreement follows the House bill and Senate amendment.

Sanctions

The conference agreement follows the House bill and Senate amendment.

Qualified benefits

The conference agreement follows the House bill and Senate amendment.

Election limitations

The conference agreement generally follows the Senate amendment, but prohibits employers from applying the limitations on elective contributions based on utilization of elective amounts or based on any other system that has the effect of avoiding the cafeteria plan rule that elective contributions not used during a year are forfeited.

Excludable employees

The conference agreement clarifies that the rule treating all benefits under a cafeteria plan as provided under plans of the same type (sec. 83(h)(3)(A)) only applies for purposes of determining which employees may be disregarded under section 89(h). Thus, the conference agreement clarifies that, for purposes of applying the cafeteria plan nondiscrimination rules, an employer may exclude a category of employees from consideration only if all employees in such category are excluded with respect to all options offered by the cafeteria plan.

k. Elective contributions under the 90-percent/50-percent test

Present Law

For purposes of the 90-percent/50-percent test, available elective contributions under a cafeteria plan are not taken into account.

House Bill

No provision.

Senate Amendment

The Senate amendment modifies the application of the 90-percent/50-percent test to cafeteria plans. Under the Senate amendment, elective contributions under a cafeteria plan may be wholly or partially taken into account for purposes of the 90-percent/50-percent test if the following requirements are satisfied:

(1) the percentage of nonhighly compensated employees eligible under the plan is equal to or less than the percentage of highly compensated employees eligible under the plan;

(2) all employees eligible under the plan are eligible under the same terms and conditions; and

(3) no highly compensated employee eligible under the plan is eligible inside or outside of the cafeteria plan for any benefit of the same type that is not available on the same terms and conditions to every nonhighly compensated employee eligible under the plan.

Conference Agreement

The conference agreement generally follows the Senate amendment with respect to the treatment of elective contributions. However, partial inclusion of salary reduction amounts with respect to any individual for purposes of the 90-percent/50-percent test is not permitted under any circumstances. In addition, the Secretary is authorized to prescribe rules under which employers are required or permitted to take into account or to disregard elective contributions for purposes of the 90-percent/50-percent test. For example, the conferees recognize that the exclusion of elective contributions may create inappropriate results in the application of the nondiscrimination tests if highly compensated employees are entitled to purchase a significant portion of their available benefits with elective contributions. Similarly, the inclusion of elective contributions may create inappropriate results if a significant portion of the nonhighly compensated employees are required to purchase all or a significant portion of their available health coverage with elective contributions. Accordingly, the conferees expect that the Secretary will prescribe rules that ensure that elective contributions by highly compensated employees, by nonhighly compensated employees, or by both are not treated in a manner that circumvents the intent of the employee benefit nondiscrimination rules.

I. Former employees

Present Law

The Reform Act did not provide any special rules with respect to the application of the employee benefit nondiscrimination rules to former employees of an employer who continue to receive benefits under an employer's plan.

House Bill

Under the House bill, employees who separated from service prior to January 1, 1987, generally may be disregarded in applying the nondiscrimination rules to former employees, except with respect to benefit increases after the effective date of the employee benefit nondiscrimination rules.

Senate Amendment

The Senate amendment makes three modifications to the House bill rule relating to former employees. First, the rule applies to all employees who separate from service prior to January 1, 1989 (rather than January 1, 1987), with respect to the level of benefits provided on December 31, 1988. Second, any Federally mandated increase in benefits with respect to an employee who separated from service prior to January 1, 1989, is not considered a benefit increase and thus is included within the rule. Third, a benefit increase after December 31, 1988, with respect to an employee who separated from service before January 1, 1989, is disregarded if (1) it is provided in the same manner to employees who separated from service after December 31, 1988, as it is to employees who separated from service before January 1, 1989, and (2) the benefit increase is nondiscriminatory with respect to employees who separated from service after December 31, 1988. A benefit increase will be considered provided in the same manner to the two groups of former employees if it is provided to the same reasonable classes of former employees within each group (e.g., all employees who satisfied certain reasonable length of service requirements).

Conference Agreement

The conference agreement follows the Senate amendment with the following modifications. First, the conference agreement clarifies that the rule does not apply to employees who are reemployed by the employer after December 31, 1988. Second, under the conference agreement, benefit reductions after December 31, 1988, with respect to employees who separate from service prior to January 1, 1989 (pre-1989 former employees), generally must be tested under the nondiscrimination rule, as follows. Each pre-1989 former employee is treated as receiving a benefit increase subject to the nondiscrimination rules to the extent that his or her benefit is not reduced as much as the pre-1989 former employee with the greatest benefit reduction. This rule is designed to prevent discrimination in favor of highly compensated former employees through a nonuniform reduction in benefits.

The requirement that benefit reductions with respect to pre-1989 former employees be tested for discrimination under section 89 is subject to the same exceptions in the Senate amendment applicable to benefit increases.

m. Definition of highly compensated employee

Present Law

Under present law, an employee is treated as highly compensated with respect to a year if, at any time during the year or the preceding year, the employee (1) was a 5-percent owner of the employer, (2) received more than $75,000 in annual compensation, (3) received more than $50,000 in annual compensation and was in the top 20 percent of employees by compensation, or (4) was an officer of the employer.

House Bill

Under the House bill, employers are entitled to elect to determine their highly compensated employees under a simplified method. Under the simplified method, an electing employer may treat employees who received more than $50,000 in annual compensation from the employer as highly compensated employees in lieu of applying the $75,000 and $50,000 compensation tests of present law.

An employer is entitled to make this election with respect to a current testing year if (1) the employer did not maintain a top-heavy plan (sec. 416) at any time during such year, and (2) at all times during such year, the employer maintained business activities and employees in at least two geographically separate areas.

Senate Amendment

The Senate amendment follows the House bill, except that the Senate amendment deletes the requirements that an employer operate in at least two geographic areas and not maintain any top-heavy plans in order to use this alternative rule.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the simplified method of determining highly compensated employees, except that the availability of this simplified method is limited to employers that maintain significant business operations in at least two significantly separate geographic areas. For this purpose, the 35-mile safe harbor for operating units under section 89 (discussed below) does not apply.

In addition, the Secretary is given authority to provide for other situations in which the alternative definition cannot be used. It is intended that the Secretary use this authority to prohibit use of the alternative definition where to do so would result in greater discrimination than permitted under the present-law definition. For example, some employees who are nonhighly compensated under the present-law definition will be considered highly compensated under the alternative definition. By excluding such highly compensated employees from the plan, the nonhighly compensated employees may be provided a lower benefit than would otherwise be permitted under the nondiscrimination rules. The conferees intend that any further restrictions would not be effective until the issuance of guidance by the Secretary describing the situations in which the alternative definition is not available.

n. Employers with no nonhighly compensated employees

Present Law

Under present law, the nondiscrimination rules applicable to statutory employee benefit plans are applied by reference to the eligibility of nonhighly compensated employees to participate in a plan or to the amount of benefits provided to nonhighly compensated employees under a plan. It is unclear under present law how these nondiscrimination rules apply in the case of an employer who has no nonhighly compensated employees.

House Bill

The House bill clarifies that the nondiscrimination rules do not apply to an employer in a year in which such employer has no nonhighly compensated employees. This rule applies separately with respect to former employees under rules prescribed by the Secretary.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

o. Special rules for part-time employees

Present Law

Under present law, under certain circumstances, employees who normally work less than 17-1/2 hours per week are disregarded in applying the nondiscrimination rules.

In addition, present law permits the employer-provided benefit to be reduced proportionately under specified rules for employees who normally work less than 30 hours per week. These rules apply only if more than 50 percent of the nonexcludable employees (determined without regard to plan provisions) normally work at least 30 hours per week.

House Bill

Determination of hours worked

The House bill provides a simplified method for determining the number of hours an employee is considered to work normally in a week. Until the end of the applicable testing year in which an employee commences work with the employer, an employee is considered to work normally the average number of hours such employee is scheduled to work during such year (disregarding any time the employee is not employed by the employer). The determination of the average scheduled hours is to be made in good faith and is to take into account periods in which it is expected that hours will be higher due to, for example, seasonal business cycles.

For subsequent testing years, an employee is considered to work normally the average number of hours worked during the preceding testing year (disregarding any time the employee was not employed by the employer). In determining the number of hours an employee has worked or is scheduled to work, rules similar to the qualified plan "hour of service" rules apply.

Proportionate reduction

The House bill modifies the conditions under which the proportionate reduction rules may be applied. Under the House bill, at the employer's election, the number of nonhighly compensated nonexcludable employees generally may be determined without regard to the rule that the shortest waiting period, lowest age, etc., required as a condition of participation under all plans of the same type is to be taken into account in determining excludable employees. This rule applies only for purposes of determining whether the proportionate reduction rule may be applied to an employer's part-time employees.

Senate Amendment

Determination of hours worked

The Senate amendment modifies the House bill method for determining the number of hours an employee is considered to work normally in a week. Under the Senate amendment, for a testing year, an employee is considered to work normally the average number of hours worked during the period in the testing year prior to the testing date. If such period is less than 60 days, an employee is considered to work normally (1) the average number of hours worked during the prior testing year, or (2) if the employee did not work at least 60 days during the prior testing year, the average number of hours such employee is scheduled to work, as of the testing date, during the longer of (i) the next 60 days, or (ii) the period between the testing date and the end of the testing year. For purposes of these rules, periods during which an employee does not work are disregarded. The amendment follows the House bill with respect to how scheduled hours are to be determined and the definition of hours worked.

Proportionate reduction

The Senate amendment allows application of the proportionate reduction rule without regard to the requirement that more than 50 percent of the nonexcludable employees normally work at least 30 hours per week.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the determination of hours worked and the proportionate reduction rule. In addition, the conference agreement clarifies that the same method for determining hours worked applies for purposes of determining whether an employee is a part-time employee under the definition of highly compensated employee (sec. 414(q)(8)(B)).

p. Excludable employees

Present Law

Under present law, the following employees generally are disregarded for purposes of the employee benefit nondiscrimination rules: (1) Employees who have not completed one year of service (or, in the case of health care benefits, six months of service), (2) employees who normally work less than 17½ hours per week, (3) employees who normally work less than six months during the year, and (4) employees who have not attained age 21. However, these exclusions are applied by substituting the shortest period of service, smallest number of hours or months, or lowest age requirement applicable to any employee for eligibility in a plan of the same type.

House Bill

Multiemployer plans

Under the House bill, the initial service requirement applicable under a multiemployer plan is not taken into account in determining the extent to which the one-year and six-month figures are reduced with respect to other plans of the employer. This special rule for multiemployer plans does not apply to a multiemployer plan that covers any professional (e.g., a doctor, lawyer, or investment banker).

Entry dates

Under the House bill, an employer may use the first day of a period of less than 31 days specified by a plan as the first day of participation in the plan after satisfaction of the initial service requirement.

Senate Amendment

Multiemployer plans

The Senate amendment extends the rule in the House bill with respect to the initial waiting period for multiemployer plans to employees excluded based on their age, part-time status, or seasonal status. Thus, the exclusion (or lack thereof) under a multiemployer plan (as defined under the House bill) of employees based on age, part-time status, or seasonal status does not affect the employer's ability to disregard employees based on different age, part-time status, or seasonal status rules.

Entry dates

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the Senate amendment. In addition, the conference agreement provides that employees of an employer who are also students attending classes at the employer may be disregarded if (1) the students are performing services as described in section 3121(b)(10) (relating to services performed by students that are disregarded for employment tax purposes) and (2) core health coverage is made available to the students by the employer.

Under the conference agreement, an employer contributing to a multiemployer plan is entitled to use the special method for determining excludable employees only if that employer does not contribute to the plan on behalf of an employee who performs professional services. Thus, the determination of eligibility for the special method is applied on a contributing employer by contributing employer basis. For purposes of this provision, professional services include the following services: Legal, medical, engineering, architecture, actuarial science, financial, consulting, accounting, and such other services as the Secretary shall determine.

q. Reporting requirements for multiemployer plans

Present Law

Under present law, employers are required to file information returns with respect to group-term life insurance plans, accident or health plans, group legal services plans, cafeteria plans, educational assistance programs, and dependent care assistance programs (sec. 6039D).

House Bill

No provision.

Senate Amendment

The Senate amendment provides that, in the case of benefits provided under a multiemployer plan, the Secretary is to allocate the reporting responsibility with respect to the plan under section 6039D between the employer and the multiemployer plan based on the agreement between the parties.

Conference Agreement

The conference agreement follows the Senate amendment.

r. Line of business

Present Law

Under present law, if an employer is treated as operating separate lines of business or operating units for a year (sec. 414(r)), the employer generally may apply the section 89 nondiscrimination rules separately to each separate line of business or operating unit for that year.

A bona fide line of business or operating unit is not treated as separate unless (1) it has at least 50 employees; (2) the employer notifies the Secretary with respect to the line or unit; and (3) either certain guidelines are satisfied based on the proportion of highly compensated and nonhighly compensated employees in the line of business or operating unit (sec. 414(r)(3)) or a determination is received from the Secretary.

Present law provides special rules for allocating employees who work for more than one line of business or operating unit to a particular line of business or operating unit.

House Bill

The House bill allows the safe-harbor rule under section 414(r)(3) to be applied based on the proportion of highly compensated and nonhighly compensated employees in a line of business or operating unit in the preceding plan year if (1) no more than a de minimis number of employees shifted to or from the line of business or operating unit since the end of the prior year; or (2) the employees shifted to or from the line of business or operating unit since the end of the prior year contained a substantially proportional number of highly compensated employees.

The House bill provides that employees who perform at least 75 percent of their services for a particular line of business or operating unit are required to be allocated to such line or unit.

The modifications also apply for qualified plan purposes.

Senate Amendment

The Senate amendment is the same as the House bill, with the following modifications.

Under the Senate amendment, activities are considered geographically separate for purposes of the operating unit rules if they are at least 35 miles apart. In addition, for testing years beginning in 1989, the classification test, passage of which is required to use the separate line of business or operating unit rule, is to be the prior-law section 410(b)(1)(B) test without regard to any modification of such test by the Secretary. These two provisions apply only for purposes of section 89 (and thus do not apply for purposes of the qualified plan coverage and nondiscrimination rules).

Conference Agreement

The conference agreement generally follows the Senate amendment, with the following modifications.

The conferees intend that the rule that operating units are considered to be in significantly separate geographic areas if they are at least 35 miles apart is a safe harbor. Under certain circumstances, the Secretary may provide that operating units that are less than 35 miles apart may be considered to be in significantly separate geographic areas. In addition, the conferees do not intend to create any inference with respect to the appropriate line of business or operating unit rules for qualified pension plan purposes, i.e., no inference is intended that the Secretary is required to adopt similar rules or more or less restrictive rules for purposes of the qualified plan coverage and nondiscrimination rules.

s. Acquisitions and dispositions

Present Law

Under present law, a rule applies under section 89(j)(8) and section 410(b)(6)(C) for certain dispositions or acquisitions of a business.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the Secretary is authorized to prescribe additional rules with respect to the application of section 89 in the case of business transactions such as acquisitions and dispositions.

Conference Agreement

The conference agreement follows the Senate amendment.

t. Qualification requirements

Present Law

Employee benefit plans generally are subject to new qualification and reporting requirements (sec. 89(k) and (l)). The qualification rules require, among other things, that the plan be in writing.

House Bill

Under the House bill, employers may comply with the written plan requirement (sec. 89(k)(1)(A)) for any plan year beginning in 1989 by completing the required, full written documentation by the end of such plan year. For plan years beginning after 1989, rules prescribed by the Secretary are to permit employers a reasonable period to move from a written plan evidenced by a collection of separate written documents to a written plan evidenced by a standalone document. Standard short-term sick pay plans are not subject to the qualification rules of section 89(k) under the House bill.

Senate Amendment

The Senate amendment follows the House bill, but deletes the inference in the House bill that, after a transition period, the writing requirement may only be satisfied by a stand-alone document.

Conference Agreement

The conference agreement follows the Senate amendment. The conferees clarify that there is no intent to imply that the written plan requirement must be satisfied by a single stand-alone document, rather than by a collection of separate written documents.

u. Group-term life insurance

Present Law

Under present law, each different option generally is a separate plan for testing purposes. This means, for example, that if two types of insurance coverage vary in any way (including the amount of required employee contributions), they will be considered separate plans.

Present law allows group-term life insurance that varies in proportion to compensation (as defined in sec. 414(s)) to be considered a single plan.

House Bill

The House bill provides an additional exception to the general rule that if two types of insurance coverage vary in any way, they will be considered separate plans. Pursuant to this exception, under rules prescribed by the Secretary, if, with respect to group-term life insurance coverage, the required employee contributions vary according to the age of the employee, this variation will not preclude treatment of the coverage as a single plan.

If an employer uses the special rule described above, and employee-purchased coverage is not treated as employer-provided, then the amount of employer-provided group-term life insurance coverage with respect to any employee is the amount that bears the same relationship to the total coverage for such employee as the employer's contribution (determined on an age-rated basis) bears to the age-rated cost of such employee's total coverage.

If the employer does not use the special rule described above, and employee-purchased coverage is not treated as employer-provided, the amount of employer-provided group-term life insurance coverage with respect to any employee is determined in the same manner, except that the total cost of any employee's coverage and the employer's contributions with respect to such coverage are to be determined without regard to the employee's age.

If an employer uses the special rule described above with respect to any group-term life insurance, then the employer is required to use the special rule with respect to all group-term life insurance coverage of the employer. Thus, with respect to such an employer, coverage available for a required employee contribution that does not vary according to age would not be considered a single plan.

Senate Amendment

Under the Senate amendment, the exception permitting group-term life insurance to vary on the basis of age also applies in the same manner to group-term life insurance coverage under which required employee contributions vary according to the age of the employee, but only up to a specified limit (e.g., the employee's cost may not exceed $*X* per $1,000 of coverage).

The Senate amendment deletes the provision under which an employer that uses the exception for age-related costs or the exception provided above must use the same exception with respect to all group-term life insurance coverage of the employer. Under the Senate amendment, if one of the exceptions is used with respect to a plan, the same exception must be used with respect to all plans aggregated with such plan for purposes of the 50-percent test and the 80-percent test. In addition, for purposes of applying the 90-percent/50-percent test and the 75-percent test, the employer is to elect to apply the tests as if it had used the general rule or one of the two exceptions with respect to all plans being tested.

The Senate amendment also modifies the definition of compensation for purposes of applying section 89 to group-term life insurance. Under the Senate amendment, for testing years beginning in 1989 and 1990, an employer may apply section 89 to group-term life insurance by using, in lieu of compensation as defined under section 414(s), base compensation. Thus, for example, overtime and bonuses could be disregarded. For testing years beginning after December 31, 1990, the employer may use base compensation, or any definition of compensation, provided that such definition of compensation is not discriminatory based on the experience in the prior year. A definition of compensation will be considered nondiscriminatory if the ratio of (1) the average compensation of the nonhighly compensated employees under the alternative definition to (2) the average compensation of the nonhighly compensated employees under section 414(s) is at least 90 percent of the same ratio for highly compensated employees.

Conference Agreement

The conference agreement follows the Senate amendment, but modifies the provision that provides two additional exceptions to the general rule that, if two types of insurance coverage vary in any way, they are considered separate plans.

The conference agreement clarifies that the use of age brackets of up to five years is not inconsistent with the provision under both exceptions that the required employee contributions increase with age. Thus, for example, an employer could establish a series of five-year age brackets and have the required employee contributions only increase when an employee moves from one bracket to another.

The conference agreement clarifies that, for purposes of the 90-percent/50-percent test and the 75-percent test, the employer may use the general definition of a group-term life insurance plan or one of the two exceptions despite the fact that the employer did not use the same definition for purposes of applying the 50-percent test to any particular plan.

The conference agreement modifies the Senate amendment by allowing employers to use any nondiscriminatory definition of compensation, as described above, not only in testing years beginning after December 31, 1990, but also in testing years beginning in 1989 and 1990. The conference agreement also modifies the standard for determining whether a definition of compensation is nondiscriminatory. Under the modified standard, a definition of compensation will be considered nondiscriminatory for purposes of applying section 89 to group-term life insurance only if the ratio of (1) the average compensation of the nonhighly compensated employees under the definition to (2) the average compensation of the nonhighly compensated employees under section 414(s) is at least 100 percent of the same ratio for highly compensated employees (rather than 90 percent as under the Senate amendment).

As under the Senate amendment, in testing years beginning in 1989 and 1990, employers also have the option of using base compensation, which would not be required to satisfy the nondiscrimination standard described above.

v. Dependent care assistance

Present Law

Under present law, a benefits test applies to dependent care assistance programs that are not treated as statutory employee benefit plans under section 89 (sec. 129(d)(8)). For purposes of applying this benefits test to salary reduction amounts, employees with compensation (as defined in sec. 414(q)(7)) below $25,000 are to be disregarded. (The introduced technical corrections bill makes this rule elective for employers.)

House Bill

For purposes of applying the special benefits test to salary reduction amounts under a dependent care assistance program that is not treated as a statutory employee benefit plan under section 89, the House bill provides that an employer may elect to take into account employees with compensation (as defined in sec. 414(q)(7)) below $25,000. Thus, the employer may elect to take into account all employees with compensation below $25,000 or may disregard employees with compensation below any specified amount lower than $25,000.

Senate Amendment

The Senate amendment follows the House bill. In addition, under the Senate amendment, an employer is entitled to elect certain alternative definitions of compensation for purposes of the $25,000 rule under rules prescribed by the Secretary provided that such definition does not overstate the number of employees with less than $25,000 of compensation under section 414(q)(7) by more than five percent based on the experience in the prior year.

Conference Agreement

The conference agreement follows the Senate amendment.

The conference agreement also provides that, for purposes of section 125, a plan will not be treated as failing to be a cafeteria plan solely because a participant elected before January 1, 1989, to receive reimbursements under the plan for dependent care assistance for periods after December 31, 1988, and such assistance is includible in income under the provisions of the Family Support Act of 1988. This rule is intended to provide relief for individuals who have made, or are in the process of making, elections with respect to dependent care assistance and who are affected by the new rules regarding taxation of dependent care assistance under the Family Support Act of 1988. This rule is similar to the rule provided under the technical corrections provisions with respect to overnight camp expenses.

w. Medical diagnostic examinations

Present Law

Under present law, all plans providing medical care (as defined under sec. 213) are health plans and thus subject to the nondiscrimination rules, including, for example, plans providing ancillary benefits such as dental or vision coverage and physical examination plans.

House Bill

The House bill clarifies the valuation of health coverage, including physical examinations.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

As under the House bill and Senate amendment, normal valuation principles are to be applied to determine the value of a medical diagnostic benefit that is included in income because it is provided on a discriminatory basis.

x. Legally required benefits

Present Law

The Reform Act authorized the Secretary, in applying the nondiscrimination rules to accident or health plans, to disregard State-mandated benefits under certain circumstances. Only ancillary benefits may be disregarded, rather than core benefits.

Under rules prescribed by the Secretary, certain benefits provided in connection with "continuation coverage" are to be disregarded in applying the nondiscrimination rules. For example, if an employer requires that a qualified beneficiary who elects continuing health coverage pay, on an after-tax basis, the maximum amount permitted under the rules of section 162(k), any excess of the value of employer-provided coverage over the amount charged is to be disregarded in applying the nondiscrimination rules.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement broadens the Secretary's authority to disregard State-mandated ancillary (i.e., noncore) benefits under certain circumstances by providing that such authority applies to all ancillary accident or health benefits required by Federal, State, or foreign law. Thus, for example, in comparing the benefits of a class of employees to the benefits of another class of employees, the Secretary may permit ancillary benefits that are required by State law for one of the classes but not for the other to be disregarded. This broadened authority does not apply to benefits provided in connection with continuation coverage (old sec. 162(k); new sec. 4980B) for which different special rules apply under present law.

y. Health care continuation rules

Present Law

Under present law, for purposes of most employee benefit provisions, certain aggregation rules are applied (sec. 414(b), (c), (m), (o), and (t)). Thus, related employers generally are treated as a single employer for purposes of these provisions. Further, under certain circumstances, leased employees are treated as employees of the lessee (sec. 414(n)).

House Bill

The technical corrections provisions of the House bill extends the rules aggregating related employers (sec. 414(b), (c), (m), (o), and (t)) and the employee leasing rules (sec. 414(n)) to the health care continuation rules.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

z. Sanctions

Present Law

Year of inclusion

Under present law, if a plan is discriminatory in a plan year, highly compensated employees are taxable on the value of the discriminatory excess in their taxable year in which or with which the plan year ends.

For example, if a plan is discriminatory and the testing year is the calendar year, then the employer has only one month to determine the discriminatory excess with respect to the highly compensated employees in order to file accurate Forms W-2 in a timely manner.

Discriminatory excess

The discriminatory excess is defined as the amount of the otherwise nontaxable employer-provided benefit (including benefits purchased with elective contributions) that would have to be purchased with after-tax employee contributions by the highly compensated employees in order for all of the nondiscrimination tests to be satisfied. In the case of group-term life insurance, the value of discriminatory coverage is the greater of the cost of coverage under section 79(c) or the actual cost of coverage.

Qualification rule sanction

If a plan fails to satisfy the new qualification requirements (sec. 89(k)), employees covered under the plan generally are to include in gross income the employer-provided benefit under the plan. For this purpose, even in the case of an insurance-type plan, an employee's employer-provided benefit is the value of the benefits, rather than the coverage, attributable to employer contributions.

Employer sanction

If the employer does not report the discriminatory excess (or other amounts includible under sec. 89) in a timely manner, the employer is subject to a penalty tax (sec. 6652(k)). The amount of the tax is equal to the product of (1) the highest individual tax rate, multiplied by (2) the employee's employer-provided benefit.

Welfare benefit funds

In general, if a voluntary employees' beneficiary association (VEBA) (sec. 501(c)(9)) or group legal services organization (GLSO) (sec. 501(c)(20)) is part of a discriminatory plan, the VEBA or GLSO is not exempt from tax under section 501(a) (sec. 505). With respect to employee benefits subject to the nondiscrimination rules of section 89, a discriminatory plan for this purpose is a discriminatory employee benefit plan within the meaning of section 89(c).

In addition, if an employer maintains a welfare benefit fund and there is a disqualified benefit provided during any taxable year, a tax is imposed on the employer equal to 100 percent of the disqualified benefit. The term "disqualified benefit" includes any post-retirement medical benefit or life insurance benefit provided with respect to a highly compensated employee under a discriminatory plan (within the meaning of sec. 505).

House Bill

Year of inclusion

The House bill provides a special rule with respect to plans with a testing year ending after September 30, and on or before December 31. Under this special rule, an employer may elect to have the discriminatory excess included in the incomes of highly compensated employees in their taxable years following the taxable year with or within which the testing year ends. If an employer makes such an election, however, the employer's deduction relating to such discriminatory excess is to be allowable only in the employer's taxable year with or within which ends the testing year following the testing year in which the discriminatory excess occurred.

Discriminatory excess

For purposes of determining and allocating the discriminatory excess with respect to a group-term life insurance plan, employer-provided coverage over $50,000 is treated as nontaxable. Thus, to the extent that the discriminatory coverage does not exceed the total coverage over $50,000, the effect of a finding of discrimination is simply the inclusion in income of the excess, if any, of the actual cost of the discriminatory coverage over the cost of such coverage under section 79(c).

Qualification rule sanction

Under the House bill, if a plan to which section 505 applies (generally, a plan part of which is a VEBA or a GLSO) violates the new qualification requirements (sec. 89(k)), the VEBA or GLSO is not to be exempt from tax under section 501(a). A plan failing to satisfy the new qualification requirements is not the type of plan for which the VEBA or GLSO tax exemption was established.

In addition, the House bill provides that, in the case of a group-term life insurance plan that fails the qualification rule, the benefits provided under the plan are to be included in the beneficiary's income rather than the employee's.

The House bill further provides for the coordination of the sanction for failure to satisfy the qualification rules with the sanction for discrimination. Generally, any amount included in the income of a highly compensated employee attributable to discriminatory coverage is to offset the amount includible under section 89(k) with respect to the same highly compensated employee for the same coverage.

If, however, any discriminatory excess would be included in the income of a highly compensated employee for a year subsequent to the year of inclusion under section 89(k) with respect to the same coverage, the coordination described above is to work in reverse, i.e., the section 89(k) inclusion is to offset the inclusion of the discriminatory excess.

Employer sanction

The penalty tax on the employer for a failure to report the discriminatory excess with respect to an employee is the penalty tax determined under present law reduced, prior to multiplication by the highest individual rate, by the amount of the discriminatory excess properly reported by the employer in a timely fashion. The same rule applies in the case of amounts includible in income by reason of a failure to satisfy the qualification rules.

Welfare benefit funds

The House bill modifies the present-law sanctions with respect to discriminatory VEBAs, GLSOs, and other welfare benefit funds because such sanctions are inconsistent with the general approach under section 89 to apply the sanction solely with respect to the discriminatory amount.

Under the House bill, if section 89 applies to a plan, a VEBA or GLSO that is part of the plan does not lose its tax-exempt status under section 501(a) merely because the plan is a discriminatory employee benefit plan (within the meaning of sec. 89(c)). In lieu of this sanction, the bill imposes an excise tax on an employer maintaining a welfare benefit fund if a discriminatory employee benefit plan is part of the fund for the testing year. The tax applies to the taxable year of the employer with or within which the testing year ends.

The amount of this excise tax is determined as follows. The first step is to determine the lesser of (1) the aggregate excess benefits (within the meaning of sec. 89(b)) provided under the plan for the testing years, or (2) the taxable income of the fund for the testing year. For this purpose, the taxable income of the fund is determined without regard to an exemption from tax pursuant to section 501(c)(9) or (c)(20). The lesser of these two amounts is then multiplied by the highest rate applicable to taxable income under section 11. This product then is offset by the amount of income tax imposed on the fund for the testing year determined under rules prescribed by the Secretary. This result is the amount of the excise tax.

The House bill also modifies the 100-percent excise tax applicable to disqualified benefits in the case of a post-retirement medical benefit or life insurance benefit that is subject to section 89. The House bill provides that the amount of the disqualified benefit subject to the tax is not to exceed the aggregate excess benefits (within the meaning of sec. 89(b)) provided under the plan.

Senate Amendment

Year of inclusion

The Senate amendment is the same as the House bill.

Discriminatory excess

The Senate amendment is the same as the House bill.

Qualification rule sanction

The Senate amendment is the same as the House bill.

Employer sanction

Under the Senate amendment, the penalty for failure to report income includible under section 89 only applies to the portion of the employee's benefit that bears the same relationship to the total benefit as the unreported amount bears to the entire amount that should have been reported.

Welfare benefit funds

The Senate amendment is the same as the House bill.

Conference Agreement

Year of inclusion

The conference agreement follows the House bill and the Senate amendment, except that the conference agreement clarifies that the rule permitting a deduction in the employer's taxable year for amounts paid within 2-1/2 months of the taxable year does not apply with respect to amounts includible in income by reason of section 89.

Discriminatory excess

The conference agreement follows the House bill and the Senate amendment.

Qualification rule sanction

The conference agreement follows the House bill and the Senate amendment.

Employer sanction

The conference agreement follows the Senate amendment.

Welfare benefit fund

The conference agreement modifies the calculation of the excise tax with respect to a discriminatory welfare benefit fund in the following respects. Under the conference agreement, with respect to any employer, the first step described above is revised so that the determination is of the lesser of (1) the aggregate excess benefits (within the meaning of sec. 89(b)) provided by the employer for the testing year under all plans of the same type or types as the plan or plans of the welfare benefit fund; or (2) the taxable income of the fund for the testing year (without regard to sec. 501(c)(9) or (c)(20)) allocable to the employer. In addition, the amount counted under clause 1 with respect to benefits of any type is limited to the excess benefits of such type provided by the employer under the welfare benefit fund, assuming that excess benefits were provided to the maximum extent possible under such welfare benefit fund or another welfare benefit fund. Also, if the welfare benefit fund is maintained by more than one employer, the taxable income of the fund is to be allocated among the employers for purposes of clause (2) above in any reasonable manner that is consistently applied and not inconsistent with rules issued by the Secretary. Further, with respect to any employer, the final step in determining the excise tax, the offset by the income tax imposed on the fund, is limited to the portion of such tax allocable to the employer, determined under rules similar to those applicable in allocating the taxable income of the fund.

The conference agreement provides that the amount of the disqualified benefit subject to the 100-percent excise tax is not to exceed the amount described in clause 1 above, as limited in the same paragraph.

aa. Inclusion in wages

Present Law

Under present law, amounts that are includible in an employee's income because the nondiscrimination requirements relating to employee benefit plans are not satisfied are not in all cases treated as wages (or compensation) for employment tax purposes.

House Bill

Under the House bill, amounts that are includible in gross income by reason of section 89 (either directly or indirectly (as in the case of sec. 129(d)(1)(B))) are included in wages (or compensation) as of the time includible in gross income for purposes of the Federal Insurance Contributions Act (sec. 3121), the Railroad Retirement Tax Act (sec. 3231(e)), the Federal Unemployment Tax Act (sec. 3306), income tax withholding (sec. 3401), and the Social Security Act (sec. 209). These provisions of the House bill do not apply to former employees who separate from service prior to January 1, 1989.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment.

bb. Self-employed individuals

Present Law

Under the Act, it is unclear whether self-employed individuals are treated as employees for purposes of the nondiscrimination rules applicable to statutory employee benefit plans.

House Bill

The House bill clarifies that, for purposes of applying the nondiscrimination rules to statutory employee benefit plans, the term "employee" includes any self-employed individual (as defined in sec. 401(c)(1)), and the term "compensation" includes such individual's earned income (as defined in sec. 401(c)(2)).

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment.

cc. Definition of plan

Present Law

Under present law, each different option generally is a separate plan for testing purposes. This means, for example, that if two types of insurance coverage vary in any way (including the amount of required employee contributions), they are considered separate plans.

House Bill

Under the House bill, each different option is valued separately, but is not considered a separate plan. A plan is a group of options with comparable values (under the otherwise applicable comparability rules). With respect to the nondiscrimination rules, the effect of these changes is only one of terminology rather than of substance.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

dd. Effective date

Present Law

In general, under the Reform Act, the new employee benefit nondiscrimination rules are effective for years beginning after the later of (1) December 31, 1987, or (2) the earlier of (a) the date that is 3 months after the date on which the Secretary issues regulations under section 89, or (b) December 31, 1988.

House Bill

Except as otherwise provided, these provisions apply as if included in the Tax Reform Act of 1986.

Under the House bill, an employer may elect to apply the new rules of section 1151 of the Act (including the nondiscrimination rules, qualification rules, reporting rules, and cafeteria plan rules) to certain group-term life insurance plans in plan years beginning after October 22, 1986. The plans for which this election is available are described in section 125(c)(2)(C).

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment. In addition, the conferees have become aware that some employers are considering changing the plan years of their employee benefit plans to delay substantially the effective date of the new nondiscrimination rules. The conferees expect that Treasury rules will disregard such changes for effective date purposes.

Further, the conferees expect that these rules will require the employer to base testing for the first testing year on all plans providing coverage during that period without regard to whether they are effective for purposes of section 89. If a discriminatory excess is calculated based on coverage that is not effective for section 89 purposes, such excess is to be prorated on the basis of the coverage in effect for section 89 purposes as described under rules prescribed by the Secretary.

C. Estate and Gift Tax: Estate Freezes

Present Law

If any person holds a substantial interest in an enterprise and in effect transfers after December 17, 1987, property having a disproportionately large share of the potential appreciation in such person's interest in the enterprise while retaining a disproportionately large share in the income of, or rights in, the enterprise, then the retention of the retained interest is treated as a retention of the enjoyment of the transferred property (sec. 2036(c)). The value of the transferred property, with appropriate adjustments for the value of the retained interest, is includible in a decedent's gross estate if the decedent retains the retained interest for life. That value is also includible if the retained interest is disposed of during the 3-year period ending on the date of the decedent's death.

Under section 2036(c), an individual and a spouse are treated as one person.

An executor has no right under Federal law to recover a portion of the estate tax attributable to property includible under section 2036 from the owner of such property.

House Bill

Scope of section 2036(c)

The House bill eliminates language stating that the retained income or rights must constitute a "disproportionately" large share of such income or rights. In addition, the House bill provides that the substantial interest requirement is met if the transferor holds a substantial interest in the enterprise either before or after the effective transfer.

Exceptions

The House bill also provides that the retention of certain interests does not cause section 2036(c) to apply. One such interest is qualified debt, which, among other things, is required to have a fixed maturity date within 15 years of issue, and not to be subordinated by its terms to the claims of general creditors. In addition, qualified debt must not grant voting rights or place any limitation (other than in a case where the debt is in default) upon the exercise of voting rights by others.

Deemed gift

If either the original transferor transfers his retained interest, or the original transferee transfers the transferred property to a person other than the original transferor or a member of the original transferor's family, then the original transferor is treated as making a gift of property to the original transferee equal to the amount which would have been includible under section 2036(c) in his estate had the transferor died at that time. No amount is later included in the transferor's estate under section 2036(c) to the extent of prior deemed gifts. Terminations, lapses and other changes in any interest in property of the transferor or transferee are treated as transfers for this purpose.

Regulatory authority

The House bill grants the Secretary of the Treasury regulatory authority to prescribe circumstances in which an individual and spouse shall not be treated as one person. In addition, the House bill requires the Secretary of the Treasury to prescribe regulations as are appropriate to carry out the purposes of section 2036(c) and to prevent avoidance of its purposes through distributions or otherwise.

Right of contribution

The House bill provides that, if any part of the gross estate consists of property includible by reason of section 2036, the estate may recover from the person receiving the property an amount which bears the same ratio to the total estate tax paid as the value of the includible property bears to the taxable estate. The House bill creates a similar right with respect to deemed gifts. The right of contribution does not apply if the decedent otherwise directs in a provision of his will.

Senate Amendment

The Senate amendment follows the House bill, with the following modifications:

Scope of section 2036(c)

The Senate amendment does not change the disproportionate income or substantial interest requirements.

Exceptions

The Senate amendment generally contains the same exceptions as in the House bill, except that it treats an interest in an enterprise qualifying under a statutory exception on January 1, 1990, as if it were excepted from section 2036(c) on December 17, 1987.

The definition of qualified debt is identical to that contained in the House bill, except that such debt need not have a fixed maturity date within 15 years of the date of issue and need not by its terms be subordinated to claims of general creditors. In addition, the requirement that qualified debt not grant voting rights permits voting rights when there is a default as to payment of interest or principal.

Deemed gift

The Senate amendment is the same as the House bill, except that terminations, lapses and other changes in interests in the enterprise are not treated as transfers. In addition, a deemed gift occurs upon the transfer of property to the original transferor, but the amount of the deemed gift is adjusted for the excess of the fair market value of such property over the consideration paid by the original transferor. Finally, the deemed gift is reduced by the value of the transferor's right to recover the gift tax attributed to a deemed gift to the original transferee.

Right of contribution

The Senate amendment is the same as the House bill, except that there is no right of contribution against a charitable remainder trust. In addition, there is no right of contribution if the decedent so directs in a revocable trust.

Finally, the right of contribution for gift tax applies only with respect to disproportionate transfers made on or after June 21, 1988, and the right of contribution for amounts includible in the estate under section 2036(a) or section 2036(b) applies only with respect to property includible by reason of transfers made after the date of enactment.

Adjustment for consideration received

The Senate amendment replaces the provision directing that appropriate adjustments be made for the value of the retained interest with one requiring that rules similar to section 2043 be applied in determining the adjustment for the consideration received. In addition, the Secretary of Treasury is directed to perform a study as to the appropriate adjustment for consideration under section 2036(c).

Conference Agreement

The conference agreement generally follows the House bill and Senate amendment with respect to common items. With respect to other items, the conference report follows the Senate amendment with the following modifications and clarifications.

Scope of section 2036(c)

The conference agreement follows the Senate amendment regarding the scope of section 2036(c), except that the agreement follows the House bill provision eliminating language stating that the retained income or rights must constitute a disproportionately large share of such income or rights.

The conference agreement does not include the House bill provision relating to the substantial interest test. The conferees understand, however, that section 2036(c) applies if a parent transfers an existing enterprise or assets from such enterprise to another enterprise in which a child owns a disproportionately large share of potential appreciation and in which the parent retains an income interest or other rights.

The conference agreement clarifies that, for purposes of the effective date of section 2036(c), with respect to property transferred prior to December 18, 1987, the failure to exercise a right of conversion or the failure to pay dividends, or the failure to exercise other rights specified in regulations issued by the Secretary of the Treasury, will not be treated as a transfer under section 2036(c). This rule applies only with respect to rights in existence prior to December 18, 1987.

Exceptions

The conference agreement follows the Senate amendment regarding exceptions to section 2036(c), except that section 2036(c) does not apply if the transferor and spouse do not retain an interest in the enterprise on January 1, 1990, or the date of the transferor's death, if earlier.

The conference agreement follows the Senate amendment with respect to the definition of qualified debt, except that the agreement follows the House bill provision requiring that qualified debt not by its terms be subordinated to the claims of general creditors. Debt which is subordinated to general creditors as a class does not satisfy this requirement. Debt may be subordinated to the claims of a specified general creditor, however, without violating the requirement.

In addition, under the conference agreement, qualified debt must have a fixed maturity date not more than 15 years from the date of issue (30 years in the case of debt secured by real property). The exception for qualified debt generally does not apply if the qualified debt is not paid within the fixed maturity date. The exception will apply, however, if a business purpose exists for the failure to pay the debt. For example, the exception applies if immediate collection of the debt would reduce the holder's ability ultimately to collect the entire debt.

Finally, under the conference agreement, the retention of a qualified trust income interest in a trust is disregarded for purposes of section 2036(c) and the trust property is treated as retained by the transferor during the period of the interest. A qualified trust income interest is any right to receive amounts determined solely by reference to the income from property [1] held in trust if (1) the right is for a period not exceeding 10 years, (2) the person holding the right transferred the property to the trust and (3) such person is not a trustee of such trust. Thus, section 2036(c) does not apply if a person transfers all the stock in a corporation to a trust in which the person retains only an income interest for a term not exceeding ten years and is not a trustee of the trust. Since the trust property is treated as retained by the transferor during the period of the interest, the section applies with respect to a corporation if a person who owns all the common and preferred stock in the corporation gives the common stock to his child while retaining an income interest in a trust which holds the preferred stock.

---

[1] Thus, a trust in which the transferor retains an annuity interest is not a qualified trust income interest.

Deemed gift

The conference agreement follows the Senate amendment regarding the deemed gift rule, except that the agreement follows the House provision treating terminations, lapses, and other changes in interests as transfers.

Under the conference agreement, the amount of the deemed gift is adjusted for the transferor's right of recovery under section 2207B. The amount of the deemed gift is reduced by this right to the extent that the failure to collect (even if collection is impossible) upon such right is treated as a transfer for Federal gift tax purposes of the uncollected amounts. The conferees understand that such a transfer occurs when the right to recovery is no longer enforceable.

In addition, there is a deemed gift when the transferred property is returned to the original transferor. The amount of the deemed gift is reduced by the excess of the fair market value of the returned property over the consideration paid by the original transferor in such return. The conference agreement thereby ensures that no gift is deemed to the extent that the returned property increases the transferor's estate.

Right of contribution

The conference agreement follows the Senate amendment regarding the right of contribution. With respect to amounts includible under section 2036(c), the right of contribution applies only with respect to property transferred after the date of enactment of this Act. When the transferred property is transferred to a discretionary trust, the original transferee is the trustee of the trust for purposes of section 2207B(b).

Regulatory authority

The conference agreement follows the House bill and the Senate amendment regarding regulatory authority. The conferees intend that spouses generally be treated as one if the retained interest in the enterprise is transferred to the spouse in a transaction which qualifies for the marital deduction (or the annual exclusion with respect to the spouse). For example, if a person transfers common stock to a child and preferred stock to a spouse, either during life or at death, section 2036(c) applies with respect to the transferee spouse, since the transfer of the preferred stock qualifies for the marital deduction (or the annual exclusion with respect to the spouse). Thus, the common stock is includible in the spouse's estate. The same result would obtain if the preferred stock is transferred to a trust in which a spouse has an interest if the spouse's interest in the trust qualifies for the marital deduction (or the annual exclusion with respect to the spouse).

Spouses would not generally be treated as one if the retained interest is not transferred in a transaction qualifying for the marital deduction (or the annual exclusion with respect to the spouse). Thus, if a person transfers property to a trust in which a spouse has only an income interest, section 2036(c) would not cause the trust to be included in the spouse's estate if the transfer to the trust does not qualify for the marital deduction (or the annual exclusion with respect to the spouse).

Adjustments for consideration received

Under the conference agreement, if a member of the transferor's family provides consideration in money or money's worth for an interest in the enterprise, and it is established to the satisfaction of the Secretary of the Treasury that such consideration originally belonged to such person and was never received or acquired (directly or indirectly) from the transferor for less than full and adequate consideration, a part of the enterprise is not includible under section 2036(c). That part is the portion of the enterprise which would otherwise have been included in the gross estate (including the value of the retained interest) times a fraction, the numerator of which is the consideration received and the denominator of which is the portion of the enterprise which would have been includible in the gross estate immediately after the disproportionate transfer (including the value of the retained interest).

For example, a parent owns all the common and preferred stock in a corporation worth $2 million. After December 17, 1987, the parent sells to his child the common stock for $1 million not directly or indirectly received or acquired from the parent. If the parent continues to hold the preferred stock until his death, one half of the value of the corporation is includible in the parent's estate.

The conferees intend that the Secretary of the Treasury promulgate regulations as are deemed appropriate to demonstrate that the consideration originally belonged to the family member and was not received directly or indirectly from the transferor. The Secretary might, for example, elevate the standard of proof for making such demonstration. Or, the Secretary might create a presumption that consideration was received from gifts made by the transferor to the transferee within a certain period of time.

The conference agreement provides that appropriate adjustments be made for the value of the retained interest. Such adjustments prevent the double inclusion of the retained interest in the transferor's estate. Thus, in the previous example, if the enterprise is worth $3 million when the parent dies and the preferred stock is worth only $1 million at that time, only $1.5 million is includible in the parent's estate, i.e., preferred stock worth $1 million and $500,000 by reason of section 2036(c).

In addition, the conference agreement authorizes the Secretary of the Treasury to promulgate regulations providing for the treatment of consideration received pursuant to extraordinary dividends and other incremental changes in the capital structure. Such changes might occur because of contributions by either the transferor or the transferee to the enterprise, or they might occur because of distributions made to such persons. The Treasury regulations may adopt such rules as are appropriate to eliminate the need to value the entire enterprise in order to make minor adjustments for consideration received by the transferor.–

D. Tax Treatment of Indian Fishing Rights

Present Law

Various treaties, Federal statutes, and executive orders reserve to Indian tribes (mostly in the West and Great Lakes regions) rights to fish for subsistence and commercial purposes both on and off reservations. Because the treaties, statutes, and executive orders were adopted before passage of the Federal income tax, they do not expressly provide whether income derived by Indians from protected fishing activities is exempt from taxation.

Indians generally are subject to Federal tax in the same manner as other U.S. citizens, absent a Federal exemption. The Tax Court has ruled in three cases that income derived by Indians from protected fishing activities is taxable, and the Internal Revenue Service has assessed deficiencies in other cases.

House Bill

No provision in H.R. 4333.

A separate House-passed bill, H.R. 2792, provides that income derived by individual members of an Indian tribe, or by a qualified Indian entity, from fishing rights-related activity is exempt from Federal and State tax, including income, social security, and unemployment compensation insurance taxes. The bill defines fishing rights-related activity to mean, with respect to an Indian tribe, any activity directly related to harvesting, processing, or transporting fish harvested in the exercise of a recognized fishing right of such tribe or to selling such fish but only if substantially all of such harvesting was performed by members of such tribe.

A qualified Indian entity is defined as an entity in which: (1) all of the equity interests are owned by tribal members; (2) substantially all of the management functions are performed by tribal members; and (3) if the entity engages in substantial processing or transporting of fish, at least 90 percent of the annual gross receipts are derived from the exercise of protected fishing rights of tribes whose members own at least a 10 percent equity interest in the entity.

If income from fishing rights-related activity is exempt from Federal tax, then such income may not be subject to tax under State or local law. The bill further provides that income derived from protected Indian fishing activities is exempt from Federal taxes only to the extent provided for by the bill. Provisions securing any fishing right for any Indian tribe in any treaty, law, or executive order shall not be construed to provide an exemption from Federal tax.

The bill is effective for all periods beginning before, on, or after the date of enactment.

Senate Amendment

The Senate amendment is the same as H.R. 2792, except with respect to two provisions. First, the Treasury Department is provided authority to issue regulations that exempt certain entities from the requirement that, if the entity engages in substantial processing or transporting of fish, at least 90 percent of the annual gross receipts must be derived from the exercise of protected fishing rights of tribes whose members own at least a 10 percent equity interest in the entity. Second, the Senate amendment does not provide that provisions securing any fishing right for any Indian tribe in any treaty, law, or executive order shall not be construed to provide an exemption from tax. Instead, the Senate amendment provides that nothing in the bill shall create any inference as to the existence or nonexistence, or the scope, of any exemption from tax for income derived from fishing rights secured by any treaty, law, or executive order.

Conference Agreement

The conference agreement follows the Senate amendment.

III. EXTENSIONS AND MODIFICATIONS OF EXPIRING TAX PROVISIONS

A. Extension of exclusion for employer-provided educational assistance

Present Law

Under prior law (taxable years beginning before January 1, 1988), an employee's gross income for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee (without regard to whether the education was job-related) if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (sec. 127). This exclusion, which expired for taxable years beginning after December 31, 1987, was limited to $5,250 of educational assistance provided with respect to an individual during a calendar year and was not available for education involving sports, games, or hobbies.

House Bill

Extension

The section 127 exclusion for educational assistance is restored retroactively to the date of expiration and is extended so that it expires for taxable years beginning after December 31, 1990. The prior-law limit of $5,250 is reduced to $1,500.

Graduate-level education

The exclusion does not apply to any payment for, or the provision of any benefits with respect to, any graduate-level courses of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or similar advanced academic or professional degree. For this purpose, the phrase "graduate-level course" means a course taken by an individual who (1) has received a bachelor's degree (or the equivalent thereof), or (2) is receiving credit toward a more advanced degree.

The section 127 limitation with respect to graduate-level courses does not affect the eligibility of tuition reduction benefits paid to graduate teaching or research assistants at colleges or universities to be excluded from income under section 117(d) subject, of course, to the limitation of section 117(c).

Sports, games, and hobbies

The House bill clarifies that education with respect to a subject commonly considered a sport, game, or hobby, such as photography or gardening, is ineligible for the exclusion unless such education (1) has a reasonable relationship to an activity maintained by the employee for profit, (2) has a reasonable relationship to the business of the employer, or (3) is required as part of a degree program.

Effective date

The provisions of the House bill are effective on the date of enactment. The amendments with respect to the $1,500 limit and graduate-level education apply to taxable years beginning after December 31, 1988. The amendment with respect to hobbies is considered a retroactive clarification of prior law.

Senate Amendment

Extension

The section 127 exclusion is restored retroactively to the date of expiration and is extended so that it expires for taxable years beginning after December 31, 1988.

Graduate-level education

The Senate amendment is the same as the House bill, except that the present law rules relating to benefits provided to graduate teaching and research assistants are retained. In other words, the Senate amendment permits amounts paid to graduate teaching and research assistants to be excluded from income under either the tuition reduction provision of section 117(d) or the educational assistance program provision of section 127.

Sports, games, and hobbies

The Senate amendment is the same as the House bill.

Single trust

It was unclear under prior law whether the prohibition on providing employees with a choice between nontaxable educational assistance benefits under section 127 and other remuneration includible in gross income prohibited the provision of taxable and nontaxable educational assistance benefits from a single trust. The Senate amendment clarifies the prior-law rules so that it is permissible to pay taxable and nontaxable educational assistance benefits from the same trust.

Effective date

Senate amendment provisions are generally effective as of the date of expiration of the exclusion. The provisions with respect to hobbies and employee choice are considered to be retroactive clarifications of prior law.

Conference Agreement

Extension

The conference agreement follows the Senate amendment.

Graduate-level education

The conference agreement follows the House bill, except that the provision is effective for taxable years beginning after December 31, 1987. In addition, the conference agreement makes permanent the rule permitting tuition reduction benefits paid to graduate teaching and research to be excluded from income under section 117(d) (subject to the compensation limit of section 117(c)).

Sports, games, and hobbies

The conference agreement follows the House bill and Senate amendment.

Single trust

The conference agreement follows the Senate amendment.

B. Extension of Exclusion for Employer-Provided Group Legal Services

Present Law

Under prior law, amounts contributed by an employer to a qualified group legal services plan for an employee or amounts reimbursed to an employee for legal services under such a plan were excluded from the employee's gross income (sec. 120). In addition, under prior law, an organization, the exclusive function of which was to provide legal services or indemnification against the cost of legal services as part of a qualified group legal services plan, was entitled to tax-exempt status (sec. 501(c)(20)). The exclusion for group legal services benefits and the tax exemption expired for taxable years ending after December 31, 1987.

House Bill

No provision.

Senate Amendment

The Senate amendment restores the exclusion for group legal services and the exemption for group legal services organizations retroactively to the date of expiration and extends them so that they expire for taxable years ending after December 31, 1988. The exclusion is limited to an annual premium value of $70. The provision under a tax-exempt trust of group legal services benefits in excess of the $70 annual limit and taxable solely for that reason will not cause the trust to lose its tax-exempt status. Similarly, for taxable years ending before January 1, 1989, the provision under a cafeteria plan of a group legal services benefit that is taxable solely because of the $70 annual limit will not disqualify the cafeteria plan.

The provision is effective as of the date of the expiration of the exclusion and exemption.

Conference Agreement

The conference agreement follows the Senate amendment.

C. Low-Income Rental Housing Tax Credit

1. Extension of the low-income rental housing tax credit

Present Law

A credit is allowed in annual installments over 10 years for qualifying low-income rental housing (Code sec. 42). To qualify as a credit project, at least 40 percent of the housing units in the project must be occupied by tenants having incomes of 60 percent or less of the area median income or at least 20 percent of the housing units must be occupied by tenants having incomes of 50 percent or less of the area median income. If property on which a low-income housing credit is claimed ceases to qualify as low-income rental housing or is disposed of before the end of a 15-year credit compliance period, a portion of the credit may be recaptured.

House Bill

The low-income rental housing credit is extended for one year, through December 31, 1990. The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Modifications to the low-income rental housing tax credit

Present Law

A tax credit payable in annual installments over 10 years is available for qualifying low-income rental housing. Credit authority is granted by State agencies subject to an annual credit authority limitation for each State.

To be a qualified low-income project, an allocation of credit authority must be received from the State in the year in which the building is placed in service. States may not carry over unused credit authority from one year to the next. A limited exception to these rules permits carry over of credit authority from the last year of authorized credit authority if a project is either new construction or a substantial rehabilitation, more than 10 percent of anticipated costs were incurred prior to 1989, and the building is placed in service by the end of 1990.

To qualify as a credit project, a low-income rental housing project must meet minimum low-income tenant occupancy requirements. In addition, the gross rent charged to low-income tenants may not exceed thirty percent of the applicable area median income qualifying as low income. Qualifying tenant incomes are adjusted for family size.

If property for which a low-income housing credit is claimed ceases to qualify as low-income rental housing or is disposed of, a portion of the credits may be recaptured. Partnerships having more than thirty-five partners, with no more than fifty percent of the partnership interests being held by corporations, may elect to have the recapture determined at the partnership level rather than at the partner level.

House Bill

The House bill provides that changes in family size resulting from death, divorce, separation, and abandonment are disregarded in determining the maximum gross rent that may be charged an existing low-income tenant.

The House bill removes the restriction on corporate ownership for certain large partnerships qualifying for special recapture treatment. The bill also reverses the election of prior law, making large partnerships subject to recapture at the partnership level rather than the partner level, unless they elect otherwise.

Committee report language is provided to clarify that a housing project is not disqualified from receiving a credit allocation solely because the developer undertook the project as a condition of receiving zoning variances for other, non-low-income rental housing property.

Senate Amendment

The Senate amendment permits a building to be placed in service in the year in which the credit allocation is received or in either of the two succeeding years provided that at least 10 percent of the expected project costs were paid by the end of the year in which the credit allocation was received. Project costs are the total costs budgeted to acquire and develop the project. These costs include costs budgeted by the taxpayer to acquire the land and any existing structure. The amendment applies only to credit allocations for new construction and substantial rehabilitations.

Conference Agreement

The conference agreement generally follows the Senate amendment with three modifications. First, the determination of whether the taxpayer has incurred at least ten percent of the total project costs is measured by calculating the following fraction. The numerator of the fraction is the taxpayer's basis (land and depreciable basis) in the property as of the close of the calendar year in which the credit allocation is made by the State authority. The denominator of the fraction is the taxpayer's reasonably expected basis (land and depreciable basis) in the property at the time the property is placed in service.

Second, the conference agreement adopts the House provision removing the restriction on corporate ownership for certain large partnerships and reversing the election of current law to recapture at the partnership rather than the partner level.

Third, the conferees concur with the House committee report regarding low-income property developed in return for the receipt of zoning variances.[1]

D. Extension and Modification of Qualified Mortgage Bond and Mortgage Credit Certificate Provisions

Present Law

Qualified mortgage bonds (QMBs) are tax-exempt bonds the proceeds of which generally must be used to make mortgage loans to first-time homebuyers. Mortgage credit certificates (MCCs) may be issued to the same persons who qualify for QMB financing. Beneficiaries of these programs are subject to two principal limits. First, the purchase price of the assisted home may not exceed 90 percent (110 percent in certain targeted areas) of the average area purchase price. Second, the income of the assisted buyer may not exceed 115 percent (140 percent for targeted areas) of the greater of area or State median income.

The benefits of the special subsidy provided by MCC- and QMB-financing are not recaptured.

Issuers of QMBs and qualified veterans' mortgage bonds are permitted to retain arbitrage profits earned on nonpurpose investments and use those profits for the benefit of assisted homebuyers. There is no maximum statutory period in which QMB proceeds must be spent for the purpose of the borrowing and no statutory bond redemption requirement if the proceeds are not so spent within a reasonable period.

House Bill

The House bill extends for two years, through December 31, 1990, authority to issue QMBs and to elect to trade-in bond volume authority to issue MCCs. In addition, the bill makes several modifications to the requirements governing these programs.

The bill adjusts the mortgagor's applicable income limit for geographical economic differences and for family size. Mortgagors' incomes are tested by reference to area median income and adjustments are made to the income limitations in those areas where housing costs are high or low compared to national standards. For families of three or more persons, the income limit in the absence of area cost adjustment is 115 percent (140 percent in targeted areas) of area median. For smaller families, the income limit in the absence of area cost adjustment is 100 percent (120 percent in targeted areas) of area median.

All or part of the subsidy provided by QMB financing or MCCs is recaptured on dispositions of assisted housing which occur within ten years of purchase by mortgagors whose income has increased substantially since the purchase of the home. The maximum amount recaptured is 1.25 percent of the original balance of the loan for each year the loan is outstanding, or 50 percent of the gain realized on the disposition, whichever is less. For sales in years six through ten the 1.25 percent per year is phased-out.

---

[1] *See*, Report 100–795, House of Representatives, p. 590.

Issuers of QMBs and qualified veterans' mortgage bonds are required to rebate to the Federal Government arbitrage profits earned on nonpurpose investments in the same manner as issuers of other revenue bonds. In addition, the bill requires all proceeds of QMBs to be used to finance loans within three years of the date of issue. Unexpended proceeds must be used to redeem outstanding bonds. Prepayments of loans must also be used to redeem outstanding bonds.

Senate Amendment

The Senate amendment extends for six months, through June 30, 1989, authority to issue QMBs and MCCs.

The amendment provides an adjustment to the mortgagor's qualifying income limitation for those areas which are deemed "high housing cost" areas. The definition of "high housing cost" area and the income adjustment are the same as in the House bill. However, the amendment does not define nor make adjustments for "low housing cost" areas. In addition, the amendment provides that the applicable income limit for the mortgagor will be the highest of 115 percent of area median income, the adjusted income limit determined for "high housing cost" areas, or 115 percent of State median income.

The amendment also directs the Treasury Department to amend its regulations to provide a method of determining the capitalized value of a ground lease for those cases in which the lease has at least thirty-five years remaining and the ground rent is known for at least the first ten years of the remaining lease term, but not for the entire term.

Conference Agreement

The conference agreement follows the House bill, with several modifications.

First, the QMB and MCC programs are extended for one year, through December 31, 1989.

Second, the conference agreement follows the Senate amendment in adjusting applicable income limits for high housing cost areas only.

Third, the conference agreement follows the Senate amendment in directing the Treasury Department to amend its regulations with respect to the treatment of certain ground leases.

Fourth, the House provision extending the arbitrage rebate rules of governmental bonds to the nonpurpose arbitrage earnings of QMBs and qualified veterans' mortgage bonds is modified to apply only to QMBs.

Fifth, the House provision imposing a three-year loan origination period after which unspent proceeds must be used to redeem bonds within the next six months, is modified to permit loans originated during that six-month period to reduce the amount of bonds to be redeemed.

Sixth, the House provision requiring use of loan prepayments to redeem bonds is modified to apply both to regular loan repayments and to prepayments; however, only amounts received ten years or more after the date the bonds are issued are required to be used to redeem bonds. The $25,000 *de minimus* amount of the House provision is increased to $250,000. Repayments received during the ten year period following original issuance may be used to make new loans.

Seventh, the House provision requiring the recapture of the QMB and MCC subsidy from certain high-income recipients, whose income increases after the financing is received and who sell their assisted houses within ten years, is modified to apply only to loans originating after December 31, 1990, with the proceeds of bonds subject to the recapture requirement included in the House bill.

In addition, the conference agreement requires the General Accounting Office to study the recapture mechanism of this legislation and make recommendations on possible improvements to effectiveness and administrability. The conferees believe that in those QMB- and MCC-assisted households where income has risen rapidly since acquisition, the special subsidy provided by the program was not necessary in order to become or remain a homeowner. While the study should address all issues it finds germane, the study should, in particular, attempt to answer the following questions: What is the best way to identify those recipients of the subsidy provided by QMBs and MCCs whose income has grown sufficiently that further subsidy is not warranted? Is it more efficacious to recapture the subsidy upon disposition or to deny the subsidy currently in those years in which the taxpayer's income crosses a specified threshold? Should the recapture of the subsidy from QMBs be effected by a different mechanism than the recapture of the subsidy from MCCs? Is it administratively appropriate and equitable to phase out recapture for those taxpayers who reside in their home for more than five years or some other specified term? What is the effect on the taxpayer's effective marginal tax rates of a recapture mechanism based upon income and what phase-ins of the mechanism might be appropriate? If a recapture mechanism is based upon realized gain upon disposition what, if any, provision should be made for the inflationary component of the gain? The study and recommendations must be delivered to the Committee on Ways and Means and the Committee on Finance by July 1, 1990.

E. Extension of Special Student Loan Bond Arbitrage Rules

Present Law

Generally, any arbitrage profits earned on nonpurpose investments acquired with the gross proceeds of any tax-exempt bond must be rebated to the United States unless the proceeds of the issue are spent within 6 months. In addition, temporary periods when bond proceeds may be invested in higher yielding investments are statutorily limited for pooled financing bonds. The Tax Reform Act of 1986 provided an exception from these requirements for certain qualified student loan bonds issued before January 1,

1989. Under the exception, arbitrage profits on nonpurpose investments earned during 18 may be retained.

Under this exception, the rebate requirement does not apply to gross proceeds earned during the initial 18-month temporary period permitted for such bonds if—

(1) the gross proceeds are used to pay costs of issuance financed with the bonds; or

(2) the gross proceeds are used to pay administrative costs of the student loan program attributable to such issue and the costs of carrying such issue, but only if the proceeds of the issue are used to make or finance qualified student loans before the end of the 18-month temporary period permitted under the Tax Reform Act of 1986. The exception does not apply if the issuer so elects.

House Bill

No provision.

Senate Amendment

The Senate amendment provides a 6-month extension of the special exception, through June 30, 1989. The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the House bill.

F. Extension of Business Energy Tax Credits for Solar, Geothermal and Ocean Thermal Property

Present Law

Three business energy tax credits are scheduled to expire after December 31, 1988. These credits and the property to which they pertain are:

(1) Business solar—10% credit
(2) Geothermal—10% credit
(3) Ocean thermal—15% credit.

These credits were extended through 1988 in the Tax Reform Act of 1986, with the tax credit rates shown above effective for eligible property placed in service during calendar year 1988.

House Bill

No provision.

Senate Amendment

These three credits are extended through June 30, 1989, at the present (1988) tax credit rates. The extension of the present energy tax credit rates are effective for property placed in service on or after January 1, 1989.

Conference Agreement

The conference agreement follows the Senate amendment with a modification that extends the present law business energy tax credits through December 31, 1989.

The conferees agree with the colloquy appearing on 113 Cong. Rec. S 15455 (Oct. 11, 1988), relating to the energy tax credit.

G. Research and Development Provisions

1. Extension of research tax credit

Present Law

A 20-percent tax credit (sec. 41) is allowed for the amount of qualified research expenses paid or incurred by a taxpayer during a taxable year that exceeds the average amount of the taxpayer's yearly qualified research expenses in the base period (generally, the preceding three taxable years). The credit also applies to certain payments to universities for basic research.

Under present law, the credit is scheduled to expire after December 31, 1988.

House Bill

Extension of credit

The present-law research credit (including the university basic research credit) is extended for two additional years, i.e., for qualified research expenses incurred through December 31, 1990. The provision is effective on the date of enactment.

GAO study

The General Accounting Office is directed to conduct a study of the structure, operation, and effectiveness of the credit, and to submit a report on the study (including any recommendations for targeting the credit more effectively and otherwise improving the credit) to the Committee on Ways and Means by December 31, 1989.

Senate Amendment

Extension of credit

The present-law research credit (including the university basic research credit) is extended for three additional months, i.e., through March 31, 1989. A pro rata rule applies for purposes of computing the extended credit pursuant to which the taxpayer's qualified research expenses (or basic research payments) for January 1, 1989 through March 31, 1989 are deemed equal to one-quarter of the taxpayer's actual qualified research expenses (or basic research payments) for January 1, 1989 through December 31, 1989. The provision is effective on the date of enactment.

GAO study

No provision.

Conference Agreement

Extension of credit

The present-law research credit (including the university basic research credit) is extended for one additional year, i.e., for qualified research expenses incurred through December 31, 1989. The provision is effective on the date of enactment.

GAO study

The conference agreement follows the House bill.

The conferees believe that research is the lifeblood of our economic progress and that effective tax incentives for research and development must be a fundamental element of America's competitiveness strategy.

The conference report extends two important incentives, the research credit and the section 861-8 allocation rules. While these incentives are important, they are not necessarily sufficient to maintain our competitive edge in technology dependent industries.

In light of this, the legislation provides for a study of the current structure of the research credit and for the timely reporting to the Congress of needed improvements in this important area of the tax law. The conferees expect the General Accounting Office to report well in advance of the scheduled expiration of the current credit in order to allow the conferees and the business community adequate time to consider any recommended changes in the present credit.

2. Denial of deduction for amounts allowed as a research credit

Present Law

The amount of any deduction allowable to a taxpayer under section 174 or any other provision for research expenses or basic research payments is not reduced by the amount of any section 41 credit also allowed to the taxpayer for the same research expenses or basic research payments.

House Bill

No deduction (under sec. 174, sec. 170, or otherwise) is allowed for that portion of the taxpayer's qualified research expenses or basic research payments otherwise allowable as a deduction for the year that equals the amount of the taxpayer's section 41 credit determined for that year. A similar rule applies where the taxpayer capitalizes, rather than expenses, qualified research expenses pursuant to section 174.

Under the provision, the taxpayer may elect not to claim the full amount of the credit that otherwise would be available, thereby avoiding reduction of the section 174 deduction where the limitation imposed by the alternative minimum tax prevents full use of the credit.

The provision is effective for taxable years beginning after December 31, 1988.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except the deduction reduction equals 50 percent of the taxpayer's section 41 credit determined for the year.

3. Allocation and apportionment of R&D expenses

Present Law

For certain taxable years beginning before August 14, 1981 and for years beginning after August 1, 1987, R&D expenses were and are allocated between U.S. and foreign source income under detailed 1977 regulations designed to allocate and apportion R&D expenses on the basis of their respective contributions to U.S. source and foreign source net income. For the intervening years, R&D expenses were allocated and apportioned under statutory rules designed with particular emphasis on encouraging R&D activity in the United States.

House Bill

U.S. persons must allocate 64 percent of U.S. R&D expenses (other than any such amount allocated to one geographical source because of legal requirements) to U.S. source income and 64 percent of foreign R&D expenses (other than any such amount allocated to one geographical source because of legal requirements) to foreign source income. The remainder of U.S. and foreign R&D expenses are to be allocated on the basis of gross sales or (subject to a limit) gross income. The amount of R&D expense allocated to foreign source income on the basis of gross income in all cases must be at least 30 percent of the amount allocated to foreign source income on the basis of gross sales. The bill also clarifies the treatment of expenses for R&D conducted in space, the high seas, and Antarctica.

With respect to U.S. R&D expenses, the bill is effective for taxable years beginning after August 1, 1987, and before January 1, 1991. With respect to foreign R&D expenses, the bill is effective for taxable years beginning after June 21, 1988, and before January 1, 1991.

Senate Amendment

The Senate amendment is the same as the House bill, except that the Senate amendment is effective for the first four months of the first taxable year beginning after August 1, 1987. In determining which R&D expenses were incurred in which four-month period of that taxable year, R&D expenses are to be treated as if incurred ratably throughout the taxable year.

Conference Agreement

The conference agreement generally follows the Senate amendment. Under the agreement, the substantive rules of the agreement regarding the allocation and apportionment of foreign R&D expenses (as well as the substantive rules regarding U.S. R&D expenses) are effective for the first four months of the first taxable year beginning after August 1, 1987, with such expenses treated as if incurred ratably throughout the taxable year.

The conferees also wish to clarify that the regulatory authority provided to Treasury under the agreement extends to providing for the source of gross income and for the adjustment of group-allocable research expenses to take account of research expenses allocated and apportioned to combined income from products produced or services performed by the 936 company, in the case of those 936 companies electing the profit split method (sec. 936(h)(5)(C)(ii)) for computing intangible property income. (Under the agreement Treasury has regulatory authority to adjust group-allocable research expenses to reflect the amount of research expenses included in computing the cost-sharing amount determined under section 936(h)(5)(C)(i)(I). The amount allocated and apportioned to combined income in the case of a 936 company electing the profit split method is computed taking into account the cost sharing amount.) Thus, where an affiliated group with qualified research and experimental expenditures has a 936 company that has elected the profit split method, the qualified research and experimental expenditures taken into account in computing combined taxable income will be an adjustment to the group's qualified research and experimental expenditures subject to allocation and apportionment under the agreement.

H. Extension of Targeted Jobs Tax Credit

Present Law

Tax credit provisions

A tax credit is available on an elective basis to employers of individuals from one or more of nine targeted groups. The nine groups consist of individuals who are either recipients of payments under a means-tested transfer program, economically disadvantaged (as measured by family income), or disabled.

The credit generally is equal to 40 percent of the first $6,000 of qualified first year wages. A credit equal to 85 percent of up to $3,000 of wages to any disadvantaged summer youth employee also is allowed. The employer's deduction for wages must be reduced by the amount of the credit.

The credit shall not apply to any amount paid or incurred to an individual who begins work for the employer after December 31, 1988.

Authorization of appropriations

Present law also authorizes appropriations for administrative and publicity expenses relating to the credit through September 30, 1988. These moneys are to be used by the IRS and Department of Labor to inform employers of the credit program.

House Bill

Under the House bill, the credit and the authorization for appropriations are extended for two years. The category of economically disadvantaged youth is restricted to include employees age 18 through 21 (rather than employees age 18 through 24).

The provision applies with respect to targeted-group individuals who begin work for the employer after December 31, 1988 and before January 1, 1991. Under the provision, the credit does not apply with respect to individuals who begin work for the employer after December 31, 1990.

The authorization for appropriations is effective for the period October 1, 1988 through September 30, 1990 (fiscal years 1989-1990).

Senate Amendment

Under the Senate amendment, the credit is extended for six months, and the authorization for appropriation is extended one year. Also, the credit for disadvantaged summer youth employees is reduced from 85 percent to 40 percent.

The provision applies with respect to targeted-group individuals who begin work for the employer after December 31, 1988 and before July 1, 1989. Under the provision, the credit does not apply with respect to individuals who begin work for the employer after June 30, 1989.

The authorization for appropriations is effective for the period October 1, 1988, through September 30, 1989 (fiscal year 1989).

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with modifications. The agreement follows the House bill provision to restrict the category of economically disadvantaged youth, except that this category will include employees age 18 to 22 rather than employees age 18 to 21. The agreement also includes the provision in the Senate amendment to reduce the credit for disadvantaged summer youth employees from 85 percent to 40 percent.

The conference agreement extends the credit to amounts paid or incurred to a targeted-group individual who begins work for the employer after December 31, 1988, and before January 1, 1990. The credit does not apply with respect to individuals who begin work for the employer after December 31, 1989.

The conference agreement provides that the authorization for appropriations is effective for the period October 1, 1988, through September 30, 1989 (fiscal year 1989).

I. Treatment of Mutual Fund Shareholder Expenses for Purposes of the 2-Percent Floor on Miscellaneous Itemized Deductions

Present Law

For taxable years beginning after December 31, 1986, miscellaneous employee and investment expenses generally are deductible by itemizers only to the extent that they exceed 2 percent of the taxpayer's adjusted gross income. As enacted in the Tax Reform Act of 1986, this 2-percent floor applies with respect to indirect deductions through regulated investment companies (mutual funds): i.e., certain investment expenses of such funds do not directly reduce the amount of the fund's income that is taxable to the shareholder, but may be deducted by the shareholder as miscellaneous deductions subject to the 2-percent floor.

The Omnibus Budget Reconciliation Act of 1987 delayed the treatment of expenses of publicly offered mutual funds as miscellaneous itemized deductions until taxable years beginning after December 31, 1987.

House Bill

Under the House bill, expenses of publicly offered mutual funds are not treated as miscellaneous itemized deductions of shareholders subject to the 2-percent floor, effective for taxable years beginning after December 31, 1987.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the treatment of expenses of publicly offered mutual funds as miscellaneous itemized deductions is delayed until taxable years beginning after December 31, 1989.

J. Financially Troubled Financial Institutions: Reorganizations, NOLs, and FSLIC/FDIC Assistance Payments

Present Law

The following three rules applying to financially troubled thrift institutions are scheduled to expire December 31, 1988:

(1) Gross income of a domestic savings and loan association does not include assistance payments from the Federal Savings and Loan Insurance Corporation ("FSLIC") and no basis reduction is required on account of such payments;

(2) Certain FSLIC-assisted acquisitions of financially troubled thrift institutions may qualify as tax-free reorganizations, without regard to the continuity of interest requirement; and

(3) Special rules apply to the carryforward of net operating losses, built-in losses, and excess credits of a thrift institution that has certain ownership changes.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the three present law rules for financially troubled thrift institutions are extended for six months, through June 30, 1989, with a modification. Under the modification, net operating losses existing at the time of the regulatory assistance, interest expense, and loan portfolio built-in losses are reduced by an amount equal to 50 percent of the tax-free FSLIC assistance payments. In the case of taxable asset acquisitions, there is no reduction in deductions on account of any payments made at the time of the acquisition to the person acquiring such assets to make up the difference between the fair market value of the assets transferred and the liabilities assumed.

The above rules are also applied during the six-month period to financially troubled banks and to payments made to such banks by the Federal Deposit Insurance Corporation ("FDIC").

The provisions are effective as follows:

(1) The extension of the tax-free treatment of assistance payments with the 50-percent cutback, and the application of these rules to banks, apply to assistance payments made pursuant to acquisitions occurring after December 31, 1988 and before July 1, 1989, and to other assistance payments made during such period unless pursuant to an acquisition occurring on or before December 31, 1988.

(2) The extension of tax-free reorganization rules, and the application of these rules to banks, apply to acquisitions after December 31, 1988 and before July 1, 1989.

(3) The extension of the carryforward rules, and the application of these rules to banks, apply to ownership changes occurring after December 31, 1988 and before July 1, 1989.

Conference Agreement

The conference agreement follows the Senate bill with modifications.

Tax attribute reduction: definition of recognized built-in portfolio losses

The conference agreement modifies the definition of the recognized built-in losses that are subject to the 50-percent cutback. Such losses include all recognized built-in portfolio losses, without regard to whether or not the amount of net unrealized built-in portfolio losses exceeds the 25-percent threshhold of section 382(h)(3)(B) of the Code.

Recognized built-in portfolio losses include built-in losses on property described in section 595(a) of the Code, and losses on marketable securities as defined in section 453(f)(2) of the Code, as well as loan portfolio built-in losses.

Certain taxable asset acquisitions: 50-percent cutback and basis recovery provisions

The conference agreement modifies the application of the 50-percent cutback in the case of taxable asset acquisitions. In the case of any acquisition of assets of any applicable financial institution to which section 381 does not apply, the 50-percent cutback does not apply with respect to assistance payments made at the time of the acquisition to the person acquiring such assets that are excludable under section 597(a) of the Code. For purposes of this subsection, payments made at the time of the acquisition shall only include cash payments. Payments made after the acquisition pursuant to notes or other rights to receive future payments (including income maintenance payments with respect to loans, payments under guarantees against loss on certain assets, or any other rights) shall be subject to the 50-percent cutback to the extent they exceed the cumulative recovery (as prescribed by the Treasury Department) of the basis that is properly allocated to such rights.

It is expected that basis shall be properly allocated to such rights under this provision and that such basis allocation shall reflect the full present value, at the time of the acquisition, of the amounts that may be received pursuant to the notes or other rights, and shall include the value of any guarantee against further declines in value with respect to guaranteed assets that may occur after the acquisition of such assets.

It is expected that the Treasury Department shall not permit the basis with respect to such rights to be recovered over a period shorter than the actual period of the note, guarantee, or other right (including extensions, if any). It is also expected that the basis recovery method prescribed by the Treasury Department may take into account yield-to-maturity principles, so that a smaller amount of basis shall generally be recovered in the earlier years than in the later years; and payments made earlier than the time reflected in the present value basis computation would be subject to the 50-percent cutback.

No deduction for tax purposes shall be allowed for any basis recovery with respect to such rights unless and until such rights finally expire. At that time, a deduction shall be allowed for the excess, if any, of the amount of basis properly allocated to such rights over the amount of payments actually received pursuant to such rights.

Repayments of assistance payments for which a prior attribute cutback occurred

The conference agreement provides that if a taxpayer repays an amount and the 50-percent cutback applied to that taxpayer with respect to such amount in a preceding taxable year, there shall be allowed as a deduction for the taxable year of repayment an amount equal to the reduction in tax attributes that was attributable to the amount repaid.

Application of section 265

Under the conference agreement, no provision of section 265 of the Code shall deny a deduction by reason of such deduction being allocable to amounts excluded from gross income under section 597 of the Code.

General effective dates of extensions and related attribute cutback

The conference agreement modifies the effective dates of the basic extension of the three special present law provisions for financially troubled thrift institutions, and for the related attribute cutback rules (including the special taxable asset acquisition provisions), as follows:

(1) The extension of the tax-free treatment of assistance payments, and the cutback of attributes with respect to such tax-free payments, apply to assistance payments made pursuant to acquisitions occurring after December 31, 1988 and before January 1, 1990, and to other assistance payments made during such period unless pursuant to an acquisition occurring on or before December 31, 1988.

(2) The extension of the tax-free reorganization rules applies to acquisitions after December 31, 1988 and before January 1, 1990.

(3) The extension of the carryforward rules applies to ownership changes occurring after December 31, 1988 and before January 1, 1990.

Application to banks

The conference agreement clarifies that the provisions with respect to assistance payments made to financially troubled banks by the Federal Deposit Insurance Corporation ("FDIC") extend to payments made pursuant to 12 U.S.C. sections 1823(c)(1) and (2), as well as to payments made pursuant to 12 U.S.C. section 1821(f).

The conference agreement modifies the effective date of the provisions with respect to financially troubled banks and payments made to such banks by the FDIC. The application of the tax-free treatment of assistance payments and the attribute cutback rules in these cases apply to assistance payments made pursuant to acquisitions occurring after the date of enactment of the provision and before January 1, 1990, and to other assistance payments made during such period unless pursuant to an acquisition occurring on or before the date of enactment.

The extension of the tax-free reorganization rules to banks applies to acquisitions after the date of enactment and before January 1, 1990.

The extension of the carryforward rules to banks applies to ownership changes occurring after the date of enactment and before January 1, 1990.

Application to certain other entities

The conference agreement also extends the provisions that apply to banks and FDIC assistance payments to entities that would be domestic building and loan associations under section 7701(a)(19) but for the fact that they do not satisfy the 60-percent asset test prescribed in section 7701(a)(19)(C), and to FSLIC assistance payments to such entities. The effective dates of the provisions with respect to such entities, including the attribute cutback rule, are the same as the effective dates of the provisions with respect to banks.

IV. REVENUE-INCREASE PROVISIONS

A. Corporate Estimated Tax Payments

Present Law

Under present law, corporations are required to make estimated tax payments four times a year. For small corporations, each installment is required to be based on an amount equal to the lesser of (1) 90 percent of the tax shown on the return or (2) 100 percent of the tax shown on the preceding year's return. For large corporations, each installment is required to be based on an amount equal to 90 percent of the tax shown on the return (except that the first payment may be based on 100 percent of the tax shown on the preceding year's return). For both large and small corporations, the amount of any payment is not required to exceed an amount which would be due if the total payments for the year up to the required payment equal 90 percent of the tax which would be due if the income already received during the current year were placed on an annual basis. Any reduction in a payment resulting from using this annualization rule must be made up in the subsequent payment if the corporation does not use the annualization rule for that subsequent payment. However, if the subsequent payment makes up at least 90 percent of the earlier shortfall, no penalty is imposed.

House Bill

A corporation that uses the annualization method for a prior payment is required to make up the entire shortfall (rather than 90 percent of the shortfall) in the subsequent payment in order to avoid an estimated tax penalty. The provision is effective for estimated tax payments required to be made after December 31, 1988.

Senate Amendment

The Senate amendment is the same as the House bill, effective for estimated tax payments required to be made after September 30, 1988.

Conference Agreement

The conference agreement follows the House bill.

B. Life Insurance Provisions

1. Treatment of single premium and other investment-oriented life insurance contracts

Present Law

Under present law, the undistributed investment income ("inside buildup") earned on premiums credited under a contract that satisfies a statutory definition of life insurance is not subject to current taxation to the owner of the contract. In addition, death benefits paid under a contract that satisfies the statutory definition are excluded from the gross income of the recipient, so that neither the owner of the contract nor the beneficiary of the contract is ever taxed on the inside buildup if the insured dies before the contract is surrendered.

Amounts received under a life insurance contract prior to the death of the insured generally are not includible in gross income to the extent that the amount received does not exceed the taxpayer's investment in the contract. Amounts borrowed under a life insurance contract generally are not treated as received and, consequently, are not includible in gross income.

House Bill

Treatment of modified endowment contracts

Distribution rules

In order to discourage the purchase of life insurance as a tax-sheltered investment vehicle, the House bill alters the Federal income tax treatment of loans and other amounts received under a class of life insurance contracts that are statutorily defined as "modified endowment contracts." Under the House bill, amounts received under modified endowment contracts are treated first as income and then as recovered basis. In addition, loans under modified endowment contracts and loans secured by modified endowment contracts are treated as amounts received under the contract. Finally, an additional 10-percent income tax is imposed on certain amounts received under modified endowment contracts to the extent that the amounts received are includible in gross income.

Under the House bill, the assignment or pledge of any portion of a modified endowment contract is not treated as an amount received under the contract if the assignment or pledge is solely to cover the payment of burial expenses or prearranged funeral expenses and the contract satisfies special rules relating to the definition of life insurance (sec. 7702(e)(2)(C)).

In determining whether amounts payable or borrowed under a modified endowment contract are received under the contract, the House bill adopts the present-law rules applicable to annuity contracts. Under these rules, any amount in the nature of a dividend or similar distribution that is retained by the insurer as a premium or other consideration paid for the contract is not includible in the gross income of the owner of the contract. Because such amounts are excludable from gross income, these retained policyholder dividends do not increase the taxpayer's investment in the contract.

Definition of modified endowment contract

A modified endowment contract is defined as any contract that satisfies the present-law definition of a life insurance contract but fails to satisfy a 7-pay test. In addition, a modified endowment contract includes any life insurance contract that is received in exchange for a modified endowment contract.

A contract fails to satisfy the 7-pay test if the cumulative amount paid under the contract at any time during the first 7 contract years exceeds the sum of the net level premiums that would have been paid on or before such time had the contract provided for paid-up future benefits after the payment of 7 level annual premiums.

The net level premiums under the 7-pay test ("7-pay premiums") are computed by applying the computational rules used in determining the net single premium under the cash value accumulation test, except that the death benefit that is provided under the contract for the first contract year is deemed to be provided until the deemed maturity date of the contract. Under the House bill, the mortality charges taken into account in computing the 7-pay premiums must be reasonable as determined under Treasury regulations and, except as provided in Treasury regulations, cannot exceed the mortality charges taken into account in determining the Federal income tax reserve for the contract. Expense charges are not taken into account in determining the 7-pay premiums.

For purposes of the 7-pay test, the term "amount paid" means the premiums paid under the contract reduced by amounts received under the contract that are not received as an annuity to the extent that such amounts are not includible in gross income and are not attributable to a reduction in the originally scheduled death benefit.

Material change rules

If there is a material change in the benefits or other terms of a contract that was not reflected in any previous determination under the 7-pay test, the contract is considered a new contract that is subject to the 7-pay test as of the date that the material change takes effect and adjustments are made in the application of the 7-pay test to take into account the greater of the cash surrender value of the contract or the premiums paid under the contract.

For purposes of this rule, a material change includes the exchange of a life insurance contract for another life insurance contract and the conversion of a term life insurance contract into a whole life insurance contract. In addition, an increase in the future benefits provided under a life insurance contract constitutes a material change unless the increase is required to satisfy the statutory definition of life insurance and the increase is attributable to (1) the payment of premiums necessary to fund the lowest death benefit payable in the first 7 contract years, or (2) the crediting of interest or other earnings with respect to such premiums.

The payment of any premium is not necessary to fund the lowest death benefit payable during the first 7 contract years to the extent that the amount of the premium exceeds the excess, if any, of (1) the single premium for the contract immediately before the premium payment, over (2) the deemed cash surrender value of the contract immediately before the premium payment.

For this purpose, the single premium for a contract is determined by applying the computational rules under the cash value accumulation test or the guideline premium requirement, whichever is applicable, except that the lowest death benefit that is provided during the first 7 contract years is deemed to be provided until the deemed maturity date of the contract.

The deemed cash surrender value of any contract equals the cash surrender value (determined without regard to any surrender charge or policy loan) that would result if the premiums paid under the contract had been credited with interest at the policy rate and had been reduced by the applicable mortality and expense charges. For this purpose, in the case of a contract that satisfies the cash value accumulation test, the policy rate equals the greater of 4 percent or the rate or rates guaranteed on the issuance of the contract. In the case of a contract that satisfies the guideline premium requirement, the policy rate equals the greater of 6 percent or the rate or rates guaranteed on the issuance of the contract. The applicable mortality and expense charges for any contract are those charges that were taken into account for prior periods under the cash value accumulation test or the guideline premium requirement, whichever is applicable.

If a life insurance contract is materially changed, in applying the 7-pay test to any new premiums paid under the contract, the 7-pay premium for each of the first 7 contract years is to be reduced by the product of (1) the greater of the premiums previously paid under the contract or the cash surrender value of the contract as of the date that the material change takes effect, and (2) a fraction, the numerator of which equals the 7-pay premium for the future benefits under the contract and the denominator of which equals the net single premium for such benefits computed using the same assumptions used in determining the 7-pay premium.

Studies of life insurance and annuity contracts

The House bill requires the Secretary of the Treasury and the Comptroller General of the United States to each conduct a separate study of (1) the effectiveness of the revised tax treatment of life insurance in preventing the sale of life insurance primarily for investment purposes, and (2) the policy justification for, and the practical implications of, the present-law treatment of earnings on the cash surrender value of life insurance and annuity contracts in light of the reforms made by the Tax Reform Act of 1986. The results of each study, as well as any recommendations that are considered advisable, are required to be submitted to the House Ways and Means Committee and the Senate Finance Committee not later than March 1, 1989.

Effective date

The provision of the House bill relating to modified endowment contracts applies to contracts that are entered into or that are materially changed on or after June 21, 1988. In determining whether a contract has been materially changed, the rules described above are to apply, except that in determining whether an increase in future benefits constitutes a material change, the death benefit payable under the contract as of June 20, 1988, is to be taken into account rather than the lowest death benefit payable during the first 7 contract years. If a contract entered into before June 21, 1988, is materially changed, the 7-pay test is to be applied to the contract with the adjustments described above.

Senate Amendment

The Senate amendment is the same as the House bill with the following clarifications and modifications.

Treatment of modified endowment contracts

Distribution rules

The Senate amendment is the same as the House bill with respect to the treatment of assignments solely to pay burial or prearranged funeral expenses, except that the Senate amendment applies to all life insurance contracts, rather than only those contracts satisfying the special definition of life insurance for burial contracts, and the Senate amendment clarifies that the treatment of assignments to cover the payment of burial or prearranged funeral expenses applies only if the policyholder does not receive cash directly or indirectly in connection with the assignment.

The Senate amendment also provides that any amount payable or borrowed under a modified endowment contract is not included in gross income to the extent that the amount is retained by the insurance company as a premium or other consideration paid for the contract or as interest or principal paid on a loan under the contract. Because amounts retained by the insurer are not included in the gross income of the taxpayer, the taxpayer's investment in the contract is not increased by the amount retained.

Under the Senate amendment, the cash surrender value of a modified endowment contract is reduced by the amount of any loan that is treated as received under the contract under the revised income inclusion rules. In addition, the investment in the contract and the cash surrender value of the contract are each increased by the amount of payments on a loan to the extent attributable to loans treated as received under the contract under the revised income inclusion rules.

The Senate amendment extends the provision of the House bill relating to the treatment of distributions from a contract that is a modified endowment contract on account of a reduction in death benefits to all modified endowment contracts without regard to the reason that the contract fails to satisfy the 7-pay test. Thus, under the Senate amendment, a contract is considered a modified endowment contract for (1) distributions that occur during the contract year that the contract fails (whether due to a death benefit reduction or otherwise) to satisfy the 7-pay test and all subsequent contract years, and (2) distributions that are made in anticipation of the contract failing to satisfy the 7-pay test as determined by the Treasury Department.

Definition of modified endowment contract

Under the Senate amendment, the mortality charges taken into account in computing the 7-pay premiums equal the mortality charges specified in the prevailing commissioners' standard table (as defined in sec. 807(d)(5)) at the time that the contract is issued or materially changed (currently 1980 CSO) except to the extent provided otherwise by the Treasury Department (e.g., with respect to substandard risks).

In the case of a contract that provides an initial death benefit of $10,000 or less and that requires at least 20 nondecreasing annual premium payments, the Senate amendment provides that the amount of the 7-pay premium for each year is increased by an expense charge of $75. All contracts issued by the same insurance company to the same policyholder are treated as a single contract for purposes of applying this rule.

Under the Senate amendment, riders to contracts are considered part of the base insurance contract for purposes of the 7-pay test. In addition, the complete surrender of a life insurance contract during the first 7 years of the contract does not in itself cause the contract to be treated as a modified endowment contract.

The Senate amendment provides that the lapse of a contract resulting in paid-up insurance in a reduced amount due to the nonpayment of premiums is not considered in applying the 7-pay test if the contract is reinstated to the original face amount within 180 days after the lapse. Finally, under the Senate amendment, the amount paid under a contract is reduced by nontaxable distributions to which section 72(e) applies whether or not attributable to a reduction in the originally scheduled death benefit.

Material change rules

The Senate amendment deletes the rule in the House bill that a death benefit increase must be required in order to satisfy the statutory definition of life insurance. Thus, under the Senate amendment, an increase in the future benefits provided under a life insurance contract constitutes a material change unless the increase is attributable to (1) the payment of premiums necessary to fund the lowest death benefit payable in the first 7 contract years or (2) the crediting of interest or other earnings with respect to such premiums.

Under the Senate amendment, the definition of necessary premium for guideline premium contracts is modified to allow aggregate premium payments equal to the greater of (1) the guideline single premium or (2) the sum of the guideline level premiums to date (without regard to the deemed cash value). In determining the necessary premiums under a contract, an increase in the death benefit provided in the contract may be taken into account to the extent necessary to prevent a decrease in the excess of the death benefit over the cash surrender value of the contract.

The Senate amendment provides that a decrease in future benefits under a contract is not considered a material change. In addition, policyholder dividends are considered other earnings that may increase the death benefit without triggering a material change.

Under the Senate amendment, the Treasury Department is granted authority to provide circumstances under which a de minimis death benefit increase is not a material change (e.g., a death benefit increase that is attributable to a reasonable cost of living adjustment determined under an established index specified in the contract).

In the case of a contract that is materially changed, the new 7-pay premium is adjusted to take into account only the cash surrender value of the contract as of the date of the material change. Thus, under the Senate amendment, in applying the 7-pay test to any new premiums paid under a contract that has been materially changed, the 7-pay premium for each of the first 7 contract years after the change is to be reduced by the product of (1) the cash surrender value of the contract as of the date that the material change takes effect, and (2) a fraction the numerator of which equals the 7-pay premium for the future benefits under the contract, and the denominator of which equals the net single premium for such benefits computed using the same assumptions used in determining the 7-pay premium.

Studies of life insurance and annuity contracts

The Senate amendment does not follow the House bill provision requiring studies on the taxation of life insurance and annuity contracts.

Effective date

The provision of the Senate amendment relating to modified endowment contracts applies to contracts entered into on or after June 21, 1988. A contract is considered entered into on or after June 21, 1988, if (1) on or after June 21, 1988, the death benefit under the contract is increased or a qualified additional benefit is increased or added to the contract and, prior to June 21, 1988, the owner of the contract did not have a unilateral right under the contract to obtain such increase or addition without providing additional evidence of insurability, or (2) the contract is converted from a term life insurance contract into a life insurance contract providing coverage other than term insurance coverage after June 20, 1988, without regard to any right of the owner under the contract to obtain such conversion.

In addition, a modified endowment contract that is entered into on or after June 21, 1988, and before the date of enactment and that is exchanged within 3 months after the date of enactment for a life insurance contract that satisfies the 7-pay test is not considered a modified endowment contract if gain (if any) is recognized on the exchange.

Conference Agreement

The conference agreement follows that Senate amendment with the following modifications and clarifications.

Treatment of modified endowment contracts

Distribution rules

The conference agreement provides that the assignment or pledge of any portion of a modified endowment contract is not treated as an amount received under the contract if the assignment or pledge is solely to cover the payment of burial expenses or prearranged funeral expenses and the maximum amount of the death benefit provided under the contract does not exceed $25,000.

In determining whether amounts payable or borrowed under a modified endowment contract are received under the contract, only an amount in the nature of a dividend or similar distribution that is retained by the insurer as a premium or other consideration paid for the contract is not includible in the gross income of the owner of the contract. Thus, for example, any amount borrowed under a modified endowment that is retained by the insurer as a premium under the contract is considered an amount received under the contract. In addition, any dividend under a modified endowment contract that is retained by the insurer as principal or interest on a loan under the contract is considered an amount received under the contract. On the other hand, any dividend under a modified endowment contract that is retained by the insurer to purchase an additional amount of paid-up insurance or a qualified additional benefit is not considered an amount received under the contract.

The conference agreement also provides rules with respect to the determination of a taxpayer's investment in the contract in the case of any loan that is treated as received under a modified endowment contract or an annuity contract. Under these rules, the investment in the contract is increased by the amount of any loan that is treated as received under the contract to the extent that the loan is includible in the gross income of the taxpayer. In addition, unlike the present-law rule for other amounts received that are excludable from gross income, the amount of any loan that is treated as received under the contract but is excludable from gross income does not affect the calculation of the taxpayer's investment in the contract. Under the conference agreement, the cash surrender value of a contract is determined without regard to the amount of any loan and the repayment of a loan (as well as any interest under the loan) does not affect a taxpayer's investment in the contract whether or not the loan was treated as received under the contract.

In order to stop the marketing of serial contracts that are designed to avoid the rules applicable to modified endowment contracts, the conference agreement provides that all modified endowment contracts issued by the same insurer (or affiliates) to the same policyholder during any 12-month period are to be aggregated for purposes of determining the amount of any distribution that is includible in gross income. In addition, all annuity contracts issued by the same insurer (or affiliates) to the same policyholder during any 12-month period are to be aggregated for purposes of determining the amount of any distribution that is includible in gross income. Finally, the Treasury Department is provided regulatory authority to prevent the avoidance of the rules contained in section 72(e) through the serial purchase of contracts or otherwise.

Definition of modified endowment contract

Under the conference agreement, the mortality charges taken into account in computing the 7-pay premiums are the same as those taken into account for purposes of the definition of a life insurance contract (as modified by this conference agreement). Thus, the mortality charges are to be reasonable as determined under Treasury regulations and, except as provided in Treasury regulations, cannot exceed the mortality charges specified in the prevailing commissioners' standard table (as defined in sec. 807(d)(5)) at the time that the contract is issued or materially changed (currently 1980 CSO).[1]

The conference agreement also modifies the provision in the Senate amendment relating to the $75 expense charge for small contracts. Under the conference agreement, in the case of a life insurance contract that provides an initial death benefit of $10,000 or less and requires at least 7 annual level premium payments (rather than 20 nondecreasing annual premium payments as provided in the Senate amendment), the amount of the 7-pay premium for each year is increased by an expense charge of $75. For purposes of determining whether a contract provides an initial death benefit of $10,000 or less, any life insurance contract previously issued by the same insurer (or affiliates) to the same policyholder is to be treated as part of such contract, except that any contract that under the effective date provisions is not treated as entered into on or after June 21, 1988, is not to be taken into account.

The conference agreement also authorizes the Treasury Department to prescribe rules for taking into account expenses solely attributable to the collection of premiums paid more frequently than annually. For example, it may be appropriate to take into account the increased expenses that are often charged under smaller contracts (e.g., those with a death benefit of $25,000 or less) and that are attributable to the required payment of premiums more frequently than annually.

---

[1] For a more detailed discussion of the mortality charges that are taken into account for this purpose, see the discussion in IV. B. 2., below.

Under the conference agreement, a reduction in benefits associated with the lapse of a contract due to the nonpayment of premiums is not considered in applying the 7-pay test if the benefits are reinstated within 90 days after the lapse (rather than 180 days after the lapse as provided in the Senate amendment).

The conference agreement provides that for purposes of the 7-pay test, the term "amount paid" means the premiums paid under the contract reduced by amounts received under the contract that are not received as an annuity to the extent that such amounts are not includible in gross income. The receipt of any amount as a loan or the repayment of a loan (as well as any interest under the loan) is not to be taken into account in determining the amount paid under a contract.

Material change rules

Under the conference agreement, a material change includes any increase in the future benefits provided under a life insurance contract with two exceptions. First, a material change does not include an increase in the future benefits provided under a contract if the increase is attributable to (1) the payment of premiums necessary to fund the lowest death benefit payable in the first 7-contract years (except that certain limited death benefit increases described in sec. 7702(e)(2)(A) and (B) may be taken into account), or (2) the crediting of interest or other earnings (including policyholder dividends) with respect to such premiums.

Second, to the extent provided in Treasury regulations, a material change does not include a death benefit increase attributable to a cost-of-living adjustment that is based on an established broad-based index (such as the Consumer Price Index) specified in the contract if (1) the period over which the cost-of-living increase is determined does not exceed the remaining period over which premiums will be paid under the contract and (2) any additional premiums required to fund the increased death benefit are paid ratably over the remaining life of the contract.

In determining whether the payment of any premium is necessary to fund the lowest death benefit payable in the first 7 contract years (taking into account the limited death benefit increases described in section 7702(e)(2(A) and (B)), the conference agreement provides one standard for contracts that satisfy the cash value accumulation test and a second standard for contracts that satisfy the guideline premium requirement. In the case of a contract that satisfies the cash value accumulation test, a premium is necessary to fund the lowest death benefit payable during the first 7 contract years to the extent that the net amount of the premium (i.e., the amount of the premium reduced by any expense charge) does not exceed the excess, if any, of (1) the attained age net single premium for the contract immediately before the premium payment,[2] over

---

[2] The attained age net single premium for a contract is to be determined by applying the computational rules under the cash value accumulation test and by assuming that the lowest death

Continued

(2) the deemed cash surrender value of the contract immediately before the premium payment.[3]

In the case of a contract that satisfies the guideline premium requirement, a premium is necessary to fund the lowest death benefit payable during the first 7 contract years to the extent that the premium paid does not exceed the excess, if any, of (1) the greater of the guideline single premium or the sum of the guideline level premiums to date,[4] over (2) the sum of the premiums previously paid under the contract.

In the case of a contract that is materially changed due to an increase in future benefits that is attributable to a premium that is not necessary to fund the lowest death benefit payable in the first 7 contract years, the amount of the premium that is not necessary to fund such death benefit is to be subject to the 7-pay test without regard to the timing of the premium payment. In applying the 7-pay test to any premiums paid under a contract that has been materially changed, the 7-pay premium for each of the first 7 contract years after the change is to be reduced by the product of (1) the cash surrender value of the contract as of the date that the material change takes effect (determined without regard to any increase in the cash surrender value that is attributable to the amount of the premium payment that is not necessary), and (2) a fraction the numerator of which equals the 7-pay premium for the future benefits under the contract, and the denominator of which equals the net single premium for such benefits computed using the same assumptions used in determining the 7-pay premium.

Studies of life insurance and annuity contracts

The conference agreement follows the House bill in requiring studies on the taxation of life insurance and annuity contracts. The results of the studies are required to be submitted to the House Ways and Means Committee and the Senate Finance Committee not later than June 1, 1989.

Effective date

The provision of the conference agreement relating to modified endowment contracts applies to contracts entered into on or after June 21, 1988. In determining whether a contract is entered into on or after June 21, 1988, for purposes of this effective date, if the death benefit payable under the contract as of October 20, 1988, increases by more than $150,000, the material change rules generally applicable under the conference agreement are to apply. In determining whether an increase in future benefits constitutes a materi-

---

benefit that is provided during the first 7 contract years is provided until the deemed maturity date of the contract, except that the limited death benefit increases described in section 7702(e)(2)(B) may be taken into account.

[3] In the case of a life insurance contract with a deemed cash surrender value in excess of the actual cash surrender value (determined without regard to any surrender charge or policy loan), the actual cash surrender value is to be substituted for the deemed cash surrender value in determining whether a premium is necessary to fund the lowest death benefit payable during the first 7 contract years.

[4] The guideline single premium and the guideline level premiums for a contract are to be determined by applying the computational rules applicable to guideline premium contracts and by assuming that the lowest death benefit that is provided during the first 7 contract years is provided until the deemed maturity date of the contract, except that the limited death benefit increases described in section 7702(e)(2)(A) may be taken into account.

al change, however, the death benefit payable under the contract as of June 20, 1988, is to be taken into account rather than the lowest death benefit payable during the first 7 contract years.

A contract is not to be considered entered into on or after June 21, 1988, under the effective date provision that applies the material change rules to a contract with a death benefit increase of more than $150,000, if as of June 21, 1988, the terms of the contract required at least 7 annual level premium payments and the policyholder continues to make the level annual premium payments in accordance with the terms of the contract as of June 21, 1988. Consequently, an ordinary whole life insurance contract that is entered into before June 21, 1988, will not be subject to the modified endowment contract provisions of the conference agreement.

In addition, under the conference agreement, a contract is considered entered into on or after June 21, 1988, for purposes of this effective date if (1) on or after June 21, 1988, the death benefit under the contract is increased or a qualified additional benefit is increased or added to the contract and, prior to June 21, 1988, the owner of the contract did not have a unilateral right under the contract to obtain such increase or addition without providing additional evidence of insurability, or (2) the contract is converted after June 20, 1988, from a term life insurance contract into a life insurance contract providing coverage other than term insurance coverage, without regard to any right of the owner under the contract to obtain such conversion.

If a contract entered into before June 21, 1988, is considered entered into on or after such date under these rules, the 7-pay test is to be applied to the contract by taking into account the cash surrender value of the contract under the material change rules of the conference agreement.

The conference agreement also provides that in the case of a modified endowment contract that (1) required at least 7 annual level premium payments on the date that the contract was entered into, (2) is entered into on or after June 21, 1988, and before the date of enactment, and (3) is exchanged within 3 months after the date of enactment for a life insurance contract that satisfies the 7-pay test, the contract that is received in exchange for the modified endowment contract is not to be considered a modified endowment contract if the taxpayer elects to recognize the gain (if any) that is realized on the exchange.

Finally, the conference agreement provides that the provision relating to the determination of a taxpayer's investment in the contract in the case of a loan under an annuity contract and the anti-abuse provision applicable to the serial purchase of annuity contracts are to apply to annuity contracts entered into after October 21, 1988. No inference is intended by this provision concerning the treatment of annuity contracts under present law.

2. Limitation on unreasonable mortality and expense charges for purposes of the definition of life insurance

Present Law

For purposes of the statutory definition of a life insurance contract, the mortality charges taken into account are the charges specified in the contract, or, if none are specified in the contract, the mortality charges used in determining the statutory reserve for the contract. For purposes of one of the alternative provisions of the statutory definition of life insurance (the guideline premium requirement), the expense charges taken into account are the expense charges specified in the contract.

House Bill

For all life insurance contracts, the mortality charges taken into account for purposes of the definition of life insurance are required to be reasonable as determined under Treasury regulations and, except as provided in Treasury regulations, may not exceed the mortality charges required to be used in determining the Federal income tax reserve for the contract. The expense charges taken into account for purposes of the guideline premium requirement must be specified in the contract and must be reasonable charges which, on the basis of the company's experience, are reasonably expected to be actually paid. If a company does not have adequate experience for purposes of determining whether expense charges are reasonably expected to be made, the determination is to be made on the basis of the experience of other insurance companies with respect to similar life insurance contracts.

The provision applies to contracts entered into or materially changed on or after July 13, 1988.

Senate Amendment

The Senate amendment does not contain a provision relating to the mortality and expense charges that are taken into account for purposes of the definition of life insurance. The Senate amendment provides that, in determining whether a contract that satisfies the statutory definition of life insurance is a modified endowment contract, the mortality charges taken into account are the mortality charges specified in the prevailing commissioners' standard tables (as determined pursuant to sec. 807(d)(5)) at the time the contract is issued or materially changed (currently 1980 CSO), except to the extent provided otherwise by the Treasury Department (e.g., with respect to substandard risks).

The provision applies to contracts entered into on or after June 21, 1988 (i.e., the effective date of the Senate amendment with respect to the treatment of modified endowment contracts). A contract is considered entered into on or after June 21, 1988, if (1) on or after that date, the death benefit is increased or qualified additional benefits are increased or added and, prior to that date, the owner of the contract did not have a unilateral right under the contract to obtain the increase or addition without providing evidence of insurability; or (2) the contract is converted from term insurance coverage to other than term insurance coverage after June 20, 1988, without regard to any right of the owner under the contract to obtain such conversion.

Conference Agreement

The conference agreement follows the House bill, with modifications.

For all life insurance contracts, the mortality charges taken into account for purposes of the definition of life insurance are required to be reasonable as determined under Treasury regulations and, except as provided in Treasury regulations, may not exceed the mortality charges specified in the prevailing commissioners' standard tables (within the meaning of section 807(d)(5)) as of the time the contract is issued. The Treasury Department is directed to issue regulations by January 1, 1990, setting forth standards for determining the reasonableness of mortality charges, including standards with respect to substandard risks. Standards set forth in such regulations that limit mortality charges to amounts less than those specified in the prevailing commissioners' standard tables are to be prospective in application. Pending the issuance of such regulations, mortality charges are to be considered reasonable if such charges do not differ materially from the charges actually expected to be imposed by the company, taking into account any relevant characteristics of the insured of which the company is aware.

For example, in determining whether it is appropriate to take into account mortality charges for any particular insured person as a substandard risk, a company should take into account relevant facts and circumstances such as the insured person's medical history and current medical condition. Other relevant factors include the applicability, if any, of State or local law prohibiting or limiting the company's inquiry into some or all aspects of the insured person's medical history or condition, increasing the potential unknown insurance risk with respect to insured persons in the jurisdiction.

The expense charges taken into account for purposes of the guideline premium requirement of the definition of life insurance are to be reasonable and are to be charges which, on the basis of the company's experience, if any, with respect to similar contracts, are reasonably expected to be actually paid. If any company does not have adequate experience to determine whether expense charges are reasonably expected to be paid, then to the extent provided in regulations, the determination is to be made on the basis of industry-wide experience. The conferees do not intend by this rule, however, that a company will be required to make an independent determination with respect to industry-wide experience. Rather, the conferees expect that regulations will provide guidance on what constitutes reasonable expense charges for similar contracts.

No inference is intended by this provision that present law does not require mortality and expense charges specified in a life insurance contract to be reasonable.

The provision is effective with respect to contracts entered into on or after October 21, 1988.

3. Valuation of group-term life insurance

Present Law

The cost of employer-provided group-term life insurance generally is included in an employee's income to the extent that such cost exceeds the cost of $50,000 of group-term life insurance. In general, the cost of employer-provided group-term life insurance is determined under a table prescribed by the Secretary of the Treasury. Present law provides that the cost with respect to any employee older than age 63 is to be determined as if such employee were age 63.

House Bill

The cost of group-term life insurance under the table prescribed by the Secretary is to reflect the age of the insured without any special rules for individuals older than age 63. Thus, the prescribed tables are to be revised to include rates for age brackets over age 64.

The provision applies to group-term life insurance provided after December 31, 1988.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Loss Transfer Rules for Alaska Native Corporations

Present Law

For taxable years beginning before 1992, Alaska Native Corporations may file consolidated returns with other corporations under rules more liberal than those generally applicable to other taxpayers and, in addition, no provision or principle of law may be applied to deny the benefit or use of losses or credits of an Alaska Native Corporation by its consolidated group.

House Bill

Under the House bill, the special consolidation rules applicable to Alaska Native Corporations (including the rule prohibiting denial of the use of losses or credits through application of any provision or principle of law) are repealed.

The provision is effective for losses and credits arising after April 26, 1988. In addition, losses and credits of an Alaska Native Corporation arising before that date cannot be used to offset income assigned (or attributable to property contributed) on or after that date, unless such use is allowable without regard to the special consolidation rules.

Senate Amendment

The Senate amendment is generally the same as the House bill, with the following modifications: (1) special rules are provided for IRS audit and judicial proceedings in connection with loss transfer transactions of Alaska Native Corporations and (2) transition relief is provided for certain Alaska Native Corporations.

Rules relating to administrative and judicial proceedings

The Secretary of the Treasury must notify an Alaska Native Corporation of any proposed adjustment to the tax liability of a taxpayer which has contracted with the Alaska Native Corporation (or its wholly owned subsidiary) for the use of its losses, if such proposed adjustment arises by reason of an asserted overstatement of losses by, or misassignment of income (or income attributable to property contributed) to an affiliated group of which the Native Corporation (or its wholly owned subsidiary) is a member.[1] This notification requirement will be satisfied if the IRS promptly provides the Alaska Native Corporation a copy of the relevant portion of the notice of proposed adjustment or preliminary notice of deficiency (30-day letter) and the relevant portion of the statutory notice of deficiency or notice of claim disallowance issued to the taxpayer.

An Alaska Native Corporation receiving notice of such a proposed adjustment has the right to submit to the IRS a written statement regarding the proposed adjustment. In addition, the Alaska Native Corporation and its designated representative has the right to meet with the IRS with respect to such proposed adjustment. Any meetings shall be subject to the reasonable discretion of the IRS as to time, place and manner. Further, the time and place of such meetings will be subject to any general standards which may be enumerated by the IRS for determining whether the selection of a time and place for interviewing a taxpayer is reasonable.

The foregoing administrative rights granted to Alaska Native Corporations will not apply if the IRS determines that an extension of the statute of limitations is necessary to permit the exercise of such rights and the taxpayer and the IRS do not agree to such an extension. Any failure by the IRS to provide the notice or grant the rights discussed above will not affect the validity of the determination by the IRS of any adjustment of tax liability.

In the case of any proceeding in a Federal court or the United States Tax Court involving such proposed adjustment, the Alaska Native Corporation, subject to the rules of such court, may file an amicus brief concerning such a proposed adjustment. There is no intention to limit other participation, if any, that a court would have granted in accordance with its rules and procedures in the absence of this provision.

No further substantive or procedural rights are granted to Alaska Native Corporations by this provision.

---

[1] For purposes of this provision, a misassignment of income (or income attributable to property contributed), includes any means by which income is sought to be transferred or diverted to another corporation so as to permit losses or credits to offset such income (or the tax attributable to such income).

Transition relief

An Alaska Native Corporation may obtain transition relief, notwithstanding the effective date of the repeal of the special consolidation rules applicable to Alaska Native Corporations, pursuant to one of the following transition rules:

(1) Certain financially distressed regional Alaska Native Corporations may transfer up to $120 million of losses (or the deduction equivalent of credits) which arose before January 1, 1989, if either (a) in the case of an insolvent corporation, such loss (or credit) is used to offset income (or tax) assigned, or attributable to property contributed, pursuant to a binding contract entered into before July 26, 1988 or (b) the Native Corporation was under the jurisdiction of a Federal district court under title 11 of the United States Code (relating to bankruptcy) on April 26, 1988. To be eligible for relief as an insolvent corporation, the balance sheet of the regional Native Corporation included in its applicable financial statement (as defined in section 56(f)(3) of the 1986 Code) for its most recent 12-month period ending on or before October 6, 1988, must reflect an excess of current liabilities over current assets (as defined in accounting literature, within the meaning of Treasury regulation section 1.56-1T(d)(2)(ii)).

(2) Up to $16.4 million of losses (or the deduction equivalent of credits) of an Alaska Native Corporation may offset income (or tax) assigned, or attributable to property contributed, pursuant to a binding contract entered into before July 26, 1988.

(3) If an Alaska Native Corporation has not engaged in any loss transfer transaction prior to April 26, 1988, up to $5 million of losses (or the deduction equivalent of credits) of such Alaska Native Corporation arising on or before December 31, 1988, may be used to offset income (or tax) assigned, or attributable to property contributed, on or before December 31, 1988.

Conference Agreement

The conference agreement follows the House bill except that it contains the provisions of the Senate amendment with respect to the rules relating to administrative and judicial proceedings and it contains a modification providing additional transition relief in certain circumstances.

Under the conference agreement, notwithstanding the House bill effective date of the repeal of the special consolidation rules applicable to Alaska Native Corporations, up to $40 million of losses (or the deduction equivalent of credits) of an Alaska Native Corporation that was in existence on April 26, 1988 may offset income (or tax) assigned, or attributable to property contributed, pursuant to a binding contract entered into before July 26, 1988.

If an Alaska Native Corporation was under the jurisdiction of a Federal district court under title 11 of the United States Code (relating to bankruptcy) on April 26, 1988, then in lieu of the foregoing relief, up to $99 million of losses (or the deduction equivalent of credits) that arise before the date 1 year after the date of enactment of this Act may offset income (or tax) assigned, or attributable to property contributed, pursuant to a binding contract entered into before the date 1 year after the date of enactment of this Act.

The $40 million loss limit established for Alaska Native Corporations in the foregoing circumstances ($99 million in the case of any described corporation in bankruptcy) does not apply to any losses of such corporations that would not have been limited by the House bill.

A contract will be considered to be binding under the transition rule for binding contracts entered into before a specified date even if it was conditioned in some way upon the continuing availability of the present law special provisions relating to Alaska Native Corporations.

The conferees clarify that any loss or credit of any Alaska Native Corporation which arises on or before April 26, 1988, may be used to offset the income or tax of another entity only if there is a binding contract contemplating such offset between that particular Native corporation and that particular entity on or before April 26, 1988. Likewise, pursuant to the transitional relief described above, losses or credits may offset income (or tax) assigned, or attributable to property contributed, pursuant to a binding contract entered into before July 26, 1988, or before the date 1 year after the date of enactment of this Act, only if there is a binding contract contemplating such an offset between the Native Corporation and the particular party to the transaction before such date.

In addition, the conferees clarify the requirement (contained in the legislative history to the House bill) that any loss or credit is treated as arising on or before April 26, 1988, (or any other required date) only if such loss or credit would have been recognized by the taxpayer using generally applicable tax law principles under the taxpayer's method of accounting if its taxable year had ended on such date. For purposes of these provisions, nothing in Treasury regulation sections 1.611-3(b)(1) and 1.611-2(a)(2) shall prevent an allowance for depletion from being treated as arising on or before such date, if the depletable resource is cut (in the case of timber) or recovered (in the case of mines, oil and gas wells, and other natural deposits) on or before such date.

The conference agreement also provides that no provision of any law shall affect the date on which an original conveyance of property to an Alaska Native Corporation is made, for purposes of determining the basis of that property in the hands of the Native Corporation for Federal tax purposes.

D. Update IRS Valuation Tables

Present Law

The IRS publishes tables that are used to value annuities, life estates, terms of years, remainders and reversions. Last published in 1984, these tables assume a 10 percent interest rate and are based on mortality assumptions published in 1969-71. On a monthly basis, the IRS publishes an applicable Federal interest rate, which is based on the average market yield of obligations of the United States.

House Bill

The House bill requires that the value of any annuity, interest for life or terms of years, remainder or reversionary interest be determined under tables (or formulas) prescribed by the Secretary of the Treasury and by using an interest rate equal to 120 percent of the Federal mid-term rate in effect under section 1274(d)(1) for the month in which the valuation date falls. The bill also requires that the tables be revised at least once every ten years to reflect the most recent mortality experience.

Senate Amendment

The Senate amendment is generally the same as the House bill, except that the interest rate is rounded to the nearest 2/10ths of one percent. In addition, at the taxpayer's election, interests in property are valued by reference to the Federal mid-term rate in effect for either of the two months preceding the valuation date.

Conference Agreement

The conference agreement follows the Senate amendment, except that the provision does not apply to interests valued with respect to qualified plans or in other situations specified in Treasury regulations. The conferees intend that such regulations will not require revision of tables where the valuation depends upon interest rate assumptions which are plan specific. The Treasury regulations and tables with respect to section 2031, however, would require revision.

The election to value an interest by reference to the Federal mid-term rate in effect for either of the two months preceding the valuation date is available only if more than an insignificant part of the property transferred qualifies for a charitable deduction for income, estate or gift tax purposes.

E. Estate Tax Provisions

1. Disallow marital deduction when spouse is not a citizen of the United States

Present Law

For U.S. citizens and residents, a deduction is allowed for Federal estate and gift tax for the value of property passing from the decedent to the surviving spouse, regardless of the spouse's citizenship. For nonresident aliens, no marital deduction is allowed for estate and gift tax purposes.

For U.S. citizens, section 2013 provides a credit for a portion of estate tax paid with respect to property transferred to the decedent by or from a person who died within ten years, before or within two years after, the decedent's death.

House Bill

The House bill denies the marital deduction for Federal estate tax purposes for property passing to an alien spouse. The bill also provides that gifts to an alien spouse exceeding $100,000 per year are taxable under the Federal gift tax.

To the extent that the marital deduction is denied because the surviving spouse is an alien, the estate of that spouse who is entitled to a section 2013 credit for the full amount of estate tax paid with respect to property received from the decedent spouse's estate, determined without regard to when the decedent spouse died.

The bill allows a marital deduction for Federal estate tax purposes for property passing from a nonresident alien to a spouse who is a U.S. citizen.

Senate Amendment

The Senate amendment follows the House bill, except that property passing at death to an alien spouse is excluded from the decedent's gross estate if situated in the U.S. and placed in a trust with a U.S. trustee in which the surviving spouse has a qualifying income interest for life. The value of such property is reduced by the amount of liability transferred with such property.

Transfers of property by the trustee are subject to an estate tax equal to the additional estate tax which would have been imposed had the distributed amount (together with previously distributed amounts) been includible in the decedent's estate. Trust income (as determined under the terms of the governing instrument and applicable local law) which is distributed prior to the surviving spouse's death is not subject to this tax.

Property held in trust is treated as having been transferred if the trustee ceases to be a U.S. citizen, or if the property is removed from the United States. When the estate tax on the decedent's estate has not yet been determined, the estate tax imposed equals the value of the transferred property times the highest estate tax rate (i.e., 55 percent under rates in effect for decedents dying in 1988) in effect at the time of the decedent's death. The section 2013 credit is available with respect to the estate tax, but with the limitations placed upon the credit under present law.

Conference Agreement

The conference agreement follows the Senate amendment and the House bill with respect to common provisions. In addition, the conference agreement contains the following modifications.

Under the conference agreement, the marital deduction is allowed for property passing to an alien spouse in a qualified domestic trust. Property passing outside the probate estate is treated as passing in a qualified domestic trust if transferred to such a trust before the estate tax return is due.

A qualified domestic trust must meet four conditions.

First, the trust instrument must require that all trustees be U.S. citizens or domestic corporations.

Second, the surviving spouse must be entitled to all the income (as determined under the terms of the governing instrument and applicable local law) from the property in the trust, payable annually or at more frequent intervals.

Third, the trust must meet the requirements of Treasury regulations prescribed to ensure collection of the estate tax imposed upon the trust. It is expected that the Treasury regulations will require that sufficient trust assets be subject to U.S. jurisdiction so as to ensure collection of estate tax with respect to the trust. The regulations might, for example, require that a portion of trust property to be situated in the United States or that the trustee be an institution with substantial U.S. assets.

Fourth, the executor must make an election with respect to the trust. This election must be made on the estate tax return and, once made, is irrevocable.

An estate tax is imposed upon corpus distributions from the trust made prior to the date of the surviving spouse's death and upon the value of property remaining in a qualified domestic trust upon the date of the surviving spouse's death. The tax is also imposed upon the trust property if a person other than a U.S. citizen or domestic corporation becomes a trustee of the trust or if the trust ceases to meet the requirements prescribed by the Secretary of the Treasury.

The amount of the estate tax is the additional estate tax which would have been imposed had the property subject to the tax been included in the decedent spouse's estate. If the estate tax for the decedent spouse's estate has not been finally determined,[1] a tentative tax is imposed using the highest estate tax rate in effect as of the date of the decedent's death. When the decedent spouse's estate tax liability is finally determined, the excess of the tentative tax over the additional estate tax which would have been imposed had the property been included in the decedent's estate tax is refundable.

The estate tax is due on the 15th day of the fourth month in the calendar year following the end of the taxable year in which the taxable event occurs. The trustee is personally liable for the estate tax, and may, under rules similar to section 2204, discharge his liability upon written application to the Secretary of the Treasury.

The tax imposed by this provision is treated as an estate tax with respect to the decedent spouse's estate. As such, it qualifies for the previously paid property tax, determined without regard to the date of the decedent spouse's death. In addition, there is a lien against property giving rise to such tax for ten years from the taxable event.

2. Repeal special rates and credits for foreign estates

Present Law

The gift and estate tax rate on U.S. citizens and residents begins at 18 percent on the first $10,000 of taxable transfers and reaches 55 percent on taxable transfers over $3 million. A unified credit of $192,800 is deducted from the gross gift or estate tax in arriving at the net tax payable. A deduction is permitted for certain property passing to a surviving spouse.

The estate tax rate on nonresident aliens begins at 6 percent on transfers of less than $100,000 and reaches 30 percent on transfers over $2 million. The statute allows such persons a credit of $3,600, which effectively exempts the first $60,000 of the estate from estate tax. No deduction is allowed for property passing to a spouse.

---

[1] A tax is not finally determined for these purposes if, for example, the statute of limitations for the decedent spouse's estate tax has not lapsed, or judicial determination of such tax is pending. A tax may be finally determined by a closing agreement.

House Bill

The gift and estate tax rate presently applicable to U.S. citizens and residents is applied to the estate of a nonresident alien. Such an estate is permitted a credit equal to the unified credit times the proportion of the total gross estate situated in the United States. A marital deduction is allowed for property passing from a nonresident alien to a spouse who is a U.S. citizen.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, except that the estate of a nonresident alien is allowed a unified credit of $13,000. This credit exempts the first $60,000 of the estate from estate tax. The conference agreement allows a unified credit of a fixed dollar amount in order to eliminate the need to determine the nonresident alien's worldwide estate in order to calculate the unified credit. Where permitted by treaty, the estate of a nonresident alien is allowed the unified credit allowed to a U.S. citizen multiplied by the proportion of the total gross estate situated in the United States. The proportional credit is allowed in these circumstances because where a treaty is involved the worldwide estate is easily determinable.

Residents of possessions are entitled to a unified credit equal to the lesser of (1) $13,000 or (2) $46,800 multiplied by the proportion of the decedent's gross estate situated in the United States.

F. Completed Contract Method of Accounting for Long-Term Contracts

Present Law

Taxpayers engaged in the production of property under a long-term contract must compute income from the contract under either the percentage of completion method or the percentage of completion-capitalized cost method. An exception to these required accounting methods is provided for certain contracts of small businesses.

Under the percentage of completion method, a taxpayer must include in gross income for any taxable year an amount that is equal to the product of (1) the gross contract price and (2) the percentage of the contract completed during the taxable year. The percentage of the contract completed during the taxable year is determined by comparing costs incurred with respect to the contract during the year with the estimated total contract costs (the cost-to-cost method).

At the time that a contract reported under the percentage of completion method is completed, a determination is made whether the taxes paid with respect to the contract for each year of the contract were greater than or less than the amount that would have been due if gross income had been computed by using the actual total contract price and actual total contract costs, rather than the anticipated contract price and costs. Interest must be paid by the taxpayer, if after applying this "look-back" method, there is an underpayment of tax by the taxpayer with respect to the taxable year. Similarly, interest must be paid to the taxpayer by the Internal Revenue Service if there is an overpayment of tax with respect to a taxable year.

Under the percentage of completion-capitalized cost method, the taxpayer must take into account 70 percent of the items under the contract under the percentage of completion method. The remaining 30 percent of the items under the contract must be taken into account under the taxpayer's normal method of accounting (e.g., the completed contract method of accounting). In addition, a taxpayer using the percentage of completion-capitalized cost method with respect to certain qualified ship contracts must take into account 40 percent of the items under the contract under the percentage of completion method and the remaining 60 percent of the items under the taxpayer's normal method of accounting.

All costs that directly benefit or are incurred by reason of the taxpayer's long-term contract activity must be allocated to the long-term contracts of the taxpayer. While costs allocated to a contract (or a portion of a contract) that is reported under the percentage of completion method generally are taken into account as a deduction from gross income for the taxable year in which incurred, the allocation of costs to the contract is nonetheless relevant because it affects the determination of the percentage of the contract that is completed during any taxable year.

In the case of any long-term contract entered into by the taxpayer on or after March 1, 1986, the taxable income from such contract must be determined under the percentage of completion method for purposes of determining the amount of alternative minimum taxable income for any taxable year.

House Bill

Under the House bill, the percentage of completion-capitalized cost method of accounting is repealed for all long-term contracts other than qualified ship contracts that are provided special treatment under present law. Consequently, taxpayers engaged in the production of property under a long-term contract (other than construction contracts of small businesses that are exempted under present law and certain qualified ship contracts) must use the percentage of completion method in computing taxable income under the contract.

The House bill also requires the Treasury Secretary to prescribe regulations that are necessary or appropriate to carry out the purposes of the long-term contract rules, including regulations that prevent the use of related parties, pass-through entities, intermediaries, options or other similar arrangements to avoid the application of the long-term contract rules.

The provision generally is effective for contracts entered into on or after June 21, 1988. The provision does not apply to any contract entered into pursuant to a written bid or proposal submitted by a taxpayer to the other party to the contract before June 21, 1988, if the bid or proposal could not have been revoked or amended by the taxpayer at any time during the period beginning on June 21, 1988, and ending on the date that the contract was entered into.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill with the following modifications.

Percentage of completion-capitalized cost method

The conference agreement changes the percentage of completion-capitalized cost method of computing income from long-term contracts. Under the conference agreement, ninety percent (versus 70 percent under present law) of the items with respect to a long-term contract are to be taken into account under the percentage of completion method. The remaining 10 percent (versus 30 percent under present law) of the items with respect to the contract are to be taken into account under the taxpayer's normal method of accounting. The look-back method of present law is applied to the 90 percent taken into account under the percentage of completion method.

Home construction contracts

Under the conference agreement, neither the percentage of completion nor the percentage of completion-capitalized cost methods of accounting apply to home construction contracts. For this purpose, a contract is a home construction contract if 80 percent or more of the estimated total costs to be incurred under the contract are reasonably expected to be attributable to the building, construction, reconstruction, or rehabilitation of, or improvements to real property directly related to and located on the site of, dwelling units in a building with four or fewer dwelling units. For this purpose, a townhouse or rowhouse will be considered a separate building irrespective of the number of other townhouses or rowhouses attached.

The conference agreement applies the use of the uniform capitalization rules of section 263A to home construction contracts other than home construction contracts of small contractors as defined by section 460(e) of present law. In addition, under the conference agreement, home construction contracts of small contractors will not be considered long-term contracts for purposes of the adjustments in computing alternative minimum taxable income of section 56.

Residential construction contracts

The percentage of completion-capitalized cost method of present law is available to residential construction contracts which do not qualify as home construction contracts. Thus, under the conference agreement, 70 percent of the items under such contracts will be taken into account under the percentage of completion method; the remaining 30 percent of the items will be taken into account under the taxpayer's normal method of accounting. Residential construction contracts are contracts other than home construction contracts for which 80 percent or more of the total estimated costs under the contract are reasonably expected to be attributed to the building, construction, reconstruction, or rehabilitation of, or improvements to real estate directly related to and located on the site of, dwelling units, as defined by section 167(k).

Simplification of the look-back method for pass-through entities

The conference agreement provides that pass-through entities (partnerships, S corporations and trusts) are required to use a simplified look-back method. Under the simplified look-back method, the amount of taxes deemed overpaid or underpaid under a contract in any year is determined by multiplying (1) the amount of contract income overreported or underreported for the year by (2) the top marginal tax rate applicable for the year. The simplified calculation, when applicable, is made at the entity level and any interest owed to or by the Internal Revenue Service shall be paid by or to the pass-through entity.

The simplified look-back method is not applicable to a contract unless substantially all the income under the contract is from sources in the United States. In addition, the simplified method cannot be used by closely-held pass-through entities. For purposes of this provision, closely-held pass-through entities are those partnerships, S corporations or trusts where 50 percent or more of the value of the beneficial interests in the entity are owned directly or indirectly by five or fewer persons.

The top marginal tax rate to be used in the simplified calculation is the top rate specified by section 11, unless more than 50 percent of the beneficial interests in the pass-through entity are held directly or indirectly by individuals at any time during the taxable year. If the closely-held entity is treated as being owned by individuals for the year, the top marginal tax rate will be the top rate specified in section 1.

The simplified look-back method is applicable as if included in the Tax Reform Act of 1986, except that the method shall not apply for any contract completed in a taxable year for which the due date of the return (including extensions) is before the enactment of this Act.

Treasury study

Under the conference agreement, the Secretary of the Treasury is directed to study and to issue a report with recommendations regarding the method or methods by which the items of income or loss from long-term contracts should be reported for Federal income tax purposes. Such study is intended to include an evaluation of the present methods of accounting for long-term contract activity as well as an analysis of the feasibility of alternative methods of reporting income under a long-term contract. Specifically, the study shall include suggestions for the simplification of the look-back method of present law, an analysis of how costs should be taken into account for purposes of the cost-to-cost method of present law, and an evaluation of methods of accounting (such as the revenue realization method) which measure progress under the contract by reference to revenues received or accrued rather than by reference to costs incurred. The study is due 6-months after the date of enactment.

G. Reduction in Dividends Received Deduction for Portfolio Stock

Present Law

Corporations owning less than 20 percent of the stock of a domestic corporation are entitled to a deduction equal to 70 percent of the dividends received from the corporation. Corporations owning at least 20 percent but less than 80 percent of the stock are entitled to an 80-percent deduction and corporations owning 80 percent or more may be entitled to a 100-percent deduction.

House Bill

The House bill contains the following provisions:

(1) The portfolio dividends received deduction is reduced from 70 percent to 50 percent.

(2) The requirement to qualify for an 80 percent dividends received deduction is changed to require ownership of more than 20 percent of the stock of a corporation.

(3) For purposes of determining whether the more than 20-percent threshold is met, the ownership of related corporations is aggregated to the same extent that it is aggregated under present law for purposes of the 80-percent threshold.

(4) The Treasury Department is directed to conduct a study of the dividends received deduction and provide any recommendations for legislative changes no later than 6 months following the date of enactment.

The provisions are effective as follows:

(a) The change in the portfolio dividends received deduction is phased in with a 55-percent deduction for dividends received in 1989, a 52½ percent deduction for dividends received in 1990, and a 50-percent deduction for dividends received after December 31, 1990.

(b) The change in the threshold for the portfolio dividends received deduction applies to dividends received after December 31, 1988.

(c) The change in the aggregation rule applies to dividends received after December 31, 1987.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the Senate amendment.

H. Tax-Exempt Bonds

1. Restrictions on issuance of pooled financing bonds

Present Law

Interest on State and local government bonds generally is tax-exempt if the bonds are issued to finance governmental activities of these governments (Code sec. 103). Interest on bonds issued by the governmental units to finance activities of other persons, i.e., private activity bonds, are taxable unless a specific exception is included in the Internal Revenue Code.

In certain cases, tax-exempt bonds are issued in pooled financing arrangements, i.e., arrangements where bonds are issued with the proceeds being used to make loans to two or more persons. In the case of bonds other than private activity bonds, no Federal statutory provisions require identification of the ultimate borrowers from (or the specific facilities to be financed by) these pooled financings at the time the bonds are issued. Further, assuming a governmental purpose exists for the borrowing, no specific statutory restrictions are imposed relating to the period during which loans must be originated, or bonds redeemed if loans are not timely originated.

Arbitrage restrictions applicable to State and local government bonds generally provide that the bond proceeds may be invested in higher yielding taxable investments for a three-year temporary period if the issuer reasonably expects to spend the proceeds for a governmental purpose within three years. The Tax Reform Act of 1986 limited the three-year temporary period for pooled financings to six months.

House Bill

General rule

The bill imposes new requirements on pooled financing issues as a condition of tax exemption. Pooled financing issues are defined as issues where an amount exceeding the lesser of five percent or $5 million of the proceeds are reasonably expected to be used (or intentionally are used) to make or finance loans (directly or indirectly) to two or more ultimate borrowers.[1] For purposes of this definition, all agencies of a governmental unit, which agencies are not instrumentalities or political subdivisions themselves, are treated as one person.

Specific requirements

Borrower identification requirement

Interest on a pooled financing issue is tax exempt only if, when the bonds are issued, written loan commitments with ultimate borrowers identifying with specificity the governmental purposes for which the proceeds will be used exist for loans equal to at least 25 percent of the net proceeds of the issue, and if it is reasonably expected at that time that the loans specified in those commitments will be made.

---

[1] In general, the term loan is defined in the same way as for purposes of the private loan restriction of present law; however, where the bond proceeds are used for a specific project (e.g., a sewer facility) and with respect to which a "loan" is present only as a result of the deemed loan, the bond proceeds are not treated as having been used to make loans for purposes of this provision.

Loan origination and redemption requirement

Interest on a pooled financing issue is tax exempt only if a statutorily prescribed loan origination and/or bond redemption requirement is satisfied at annual intervals during each of the three years following issuance of the bonds.

Loan origination

The loan origination portion of this requirement is as follows:

(1) Within one year after the date the bonds are issued, loans to ultimate borrowers must have been originated in an amount equal to at least 25 percent of the net proceeds of the issue.

(2) Within two years after the date the bonds are issued, loans to ultimate borrowers must have been originated in an amount equal to at least 50 percent of the net proceeds of the issue.

(3) Within three years after the date the bonds are issued, loans to ultimate borrowers must have been originated in an amount equal to 100 percent of the net proceeds of the issue.

Bond redemption

The bond redemption portion of this requirement applies both with respect to proceeds that are unoriginated as of expiration of any of the three loan origination periods and to amounts received at any time as repayments of loan principal. Bond proceeds which are required to be used to make loans within each prescribed loan origination period, described above, and which are not so used must be used to redeem bonds that are a part of the issue no later than six months after expiration of the loan origination period. The bond redemption requirement also applies to amounts received as loan repayments (including repayments received during the three-year loan origination period).[2] All amounts received as repayments must be used to redeem bonds that are a part of the pooled financing issue no later than the close of the first semi-annual period beginning after the date the repayments are received.

Application to refunding issues

Generally the pooled financing requirements apply to refunding (both current and advance) issues as well as to new-money issues. In the case of refunding issues, the three loan origination periods and accompanying bond redemption requirements are determined from the date the refunded bonds (original bonds in the case of a series of refundings) were issued and the borrower identification requirement is determined by reference to the refunded issue.

However, if an ultimate borrower of a pooled financing issue provides for the payment of its portion of the pooled bonds through an advance refunding of its loan, the advance refunding is treated as an advance refunding of the pooled bonds for purposes of applying section 149(d) of the Code with respect to future advance refundings of the pooled bonds.

---

[2] Under the House bill, amounts contributed to a reasonably required reserve or replacement fund are not treated as loan repayments. Whether amounts are considered to be a part of such a reasonably required fund is determined under the present law rules, including the rule relating to reserves required by a master legal document adopted before August 16, 1986.

Further, the advance refunding of an issue is not, *per se*, treated as a loan repayment.

Effective date

The provision applies to bonds (including refunding bonds) issued after July 15, 1988. A transitional exception is provided for certain refundings of bond issued before July 16, 1988.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with modifications. First, the conference agreement deletes the borrower identification requirement and the bond redemption requirement.

Second, the conference agreement provides an alternative loan origination requirement. The issuer must reasonably expect that at least 95 percent of the proceeds intended to be lent will be lent by the end of the third year after the date of issue. An increase in interest rates or anticipated changes in Federal income tax laws may not be used as a basis for reasonable expectations. Further, the conferees intend that investment of bond proceeds in guaranteed investment contracts which do not permit significant draw downs to originate loans during the three year period will be prima facie evidence that the reasonable expectations test is not satisfied. An issuer's past experience regarding loan origination is a criterion upon which the reasonableness of the issuers expectations can be based.

As under the House bill, a loan is treated as made when funds are disbursed. The conferees wish to clarify, however, that this includes disbursal into an account maintained by the issuer as paying agent for the borrower, provided that the funds in the account are owned by the borrower for Federal income tax purposes. Also, interest must accrue on amounts in the account from the date the funds are disbursed into the account and an initial drawdown of more than a *de minimis* amount must occur at that date to pay project costs. Project costs may include such costs as engineers and architects fees, but would not include costs associated with issuance of the bonds.

Third, the conference agreement provides that all legal and underwriting costs associated with issuance of the bonds may not be contingent and must be substantially paid within 180 days of the date of issuance.

Finally, the conferees intend that the Treasury Department is to monitor closely blind pool issues to assure conformity with these and other applicable provisions including adequate demand surveys to justify issue size. The conferees further intend that Treasury will report to the Committees on Ways and Means and Finance any abuses that it finds, including the excessive issuance of tax-exempt bonds in pool-bond type arrangements.

Effective date.—The conference agreement applies to bonds issued after October 21, 1988.

In addition, the transitional exception in the House bill for certain refunding bonds is conformed to the October 21, 1988, effective date. Under this modified exception, the three-year loan origination test for refundings of bonds issued before October 22, 1986, will expire on October 21, 1990. For refundings of bonds issued before October 22, 1988, with respect to which the period ends after October 21, 1989, the portion of the refunding issue to be used to make new loan will be treated as a separate issue subject to the requirements of the conference agreement.

2. Student loan bonds

a. Reduction in permitted purpose arbitrage on loans financed with tax-exempt student loan bonds

Present Law

Tax-exempt bonds may be issued to finance student loans in connection with the Federal Guaranteed Student Loan program and the Parents' Loans for Undergraduate Students program. Additionally, tax-exempt financing is permitted for certain other State student loan programs of general application (Code sec. 144).

Tax-exempt student loan bonds are subject to the arbitrage restrictions of the Code like other tax-exempt bonds. Treasury Department regulations permit issuers of pooled financing bonds generally to earn arbitrage profits on their "program" investments of 1.5 percentage points over the rate paid on the underlying bonds plus amounts necessary to pay issuance and administrative costs relating to the bonds.

The Department of Education pays a special interest subsidy on student notes financed with proceeds of student loan bonds issued in connection with the Federal GSL program. Under present law, these special allowance payments ("SAP" payments) are not included in determining the amount of arbitrage earned on student notes.

House Bill

Under the House bill, the permitted arbitrage profits that may be earned on loans financed with tax-exempt student loan bonds are reduced from 1.5 percentage points to no more than 1.0 percentage point.

In addition, for Federally guaranteed student loan bonds, SAP payments will be included in calculating permitted arbitrage (payments will be treated as interest paid by the students with regard to whose loans the Federal Government makes the payments).

This provision applies to bonds (including refunding bonds) issued after July 31, 1988. For refundings after July 31, 1988, of bonds issued before August 1, 1988, however, the bill applies only to loans originated on or after the date of the refunding.

Senate Amendment

No provision.

Conference Agreement

The Conference agreement follows the House bill with an amendment in the nature of a substitute. Under the substitute, if Treasury fails exercise present law regulatory authority by July 1, 1989, it must report to the Congress reasons for not doing so.

b. Loan origination and bond redemption requirements for tax-exempt student loan bonds

Present Law

Tax-exempt bonds may be issued to finance student loans in connection with (a) the Federal Guaranteed Student Loan program and the Parents' Loans for Undergraduate Student's program, and (b) certain other State programs of general application. There is no statutorily imposed period during which student loans must be originated or bonds redeemed.

House Bill

The bill requires that all proceeds of tax-exempt student loan bonds required to be used to finance student loans be so used no later than the date which is three years after the bonds are issued, and provides that no loans may be made after the close of this three-year loan origination period. Any proceeds required to be used for student loans that remain unspent at that time must be used to redeem bonds forming a part of the issue no later than six months after expiration of the three-year loan origination period.

Additionally, the bill requires that amounts received from repayments of student loans be used to redeem bonds no later than the close of the first semi-annual period beginning after the repayments are received.

This provision applies to bonds (including refunding bonds) issued after July 31, 1988. In the case of an issue to refund bonds issued before August 1, 1988, the requirement that loan repayments be used to redeem bonds applies only to repayments received on and after the date of the refunding.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the Senate amendment.

3. Restrictions on bonds used to provide residential rental housing

Present Law

Interest on bonds to finance governmental activities of States and local governments is tax-exempt. Unless a specific exception applies in the Internal Revenue Code, interest on bonds to finance activities of any person other than a State or local government is taxable. No special restrictions apply to rental housing financed with governmental bonds. Tax-exempt bonds may be used by private, for-profit persons to finance residential rental housing only if the housing meets low-income tenant occupancy requirements. Tax-exempt bonds may also be used by section 501(c)(3) organizations to finance residential rental housing provided one of the exempt purposes of the section 501(c)(3) organization is to provide such housing. No low-income tenant occupancy requirements comparable to those for private, for-profit persons apply to rental housing financed with tax-exempt bonds issued on behalf of a qualifying sec. 501(c)(3) organization.

House Bill

The House bill generally extends the for-profit low-income tenant occupancy requirement to residential rental property for family units financed with qualified 501(c)(3) bonds. Residential rental property for family units means only those properties which are used other than on a transient basis and which are available to members of the general public. The property also must be comprised of housing units which contain separate and complete facilities for living, sleeping, eating, cooking, and sanitation. In addition, the bill provides an exception for certain continuing care or life care facility housing.

The House bill provides that any residential rental property for family units that is located outside the boundaries of a governmental unit by or on behalf of whom governmental bonds are issued and that is financed with the bonds is treated as investment-type property subject to the Code arbitrage restrictions.

Senate Amendment

The Senate amendment contains a sense of the Senate resolution in opposition to the House provision.

Conference Agreement

The conference agreement follows the House bill, with modifications. First, for governmental bonds, an exception is provided to the rule treating residential rental property located outside the issuer's jurisdiction as investment property for such property which the issuer is required to provide pursuant to a Federal or State court ordered or approved housing desegregation plan.

Second, for qualified 501(c)(3) bonds, the conference agreement limits the application of the House provision requiring the application of a low-income tenant occupancy requirement to bonds used for the acquisition of existing property. Thus, bonds used to finance construction of residential rental property, the original use of which commences with the beneficiary of the bonds, are not subject to a low-income tenant occupancy requirement. For this purpose, residential rental property that is substantially rehabilitated, within the meaning of the rehabilitation credit, is treated as new property not subject to the low-income tenant occupancy requirement.

Thus, as under the rehabilitation credit rules, rehabilitation expenditures incurred within a 24-month testing period must exceed the greater of (a) the adjusted basis of the property, or (b) $5,000.

(The special 60-month phased rehabilitation exception does not apply under this provision (sec. 48(g)(1)(C)(ii).) Additionally, for purposes of this provision, the 24-month testing period must commence within the 12 months preceding or following the date the property is acquired with the bond proceeds by the section 501(c)(3) organization.

The conferees intend that the Secretary of the Treasury have authority to extend the 24-month testing period in the event that rehabilitation is delayed by unforeseen circumstances. For example, a fire resulting from an act of God might present reasonable grounds on which to petition the Secretary for an extension of the 24-month testing period.

The conference agreement also deletes the exception for continuing care facilities. Thus, the above rule also applies to that component of a continuing care facility which constitutes residential rental property.

The conference agreement delays the general effective date of the provision from bonds issued after July 14, 1988, to bonds issued after October 21, 1988.

I. Excise Tax Provisions

1. Excise tax on pipe tobacco

Present Law

Excise taxes are imposed on cigars, cigarettes, cigarette paper and tubes, and on snuff and chewing tobacco. The tax on small cigarettes is 16 cents per pack of 20 cigarettes.

House Bill

The bill imposes an excise tax of $2.67 per pound on pipe tobacco manufactured in or imported into the United States. (This tax rate is equivalent to the minimum rate per pound currently imposed on small cigarettes.) "Pipe tobacco" means any tobacco which, because of its appearance, type, packaging, or labeling, is likely to be offered to, or purchased by, consumers as tobacco to be smoked in a pipe.

The provision is effective for pipe tobacco removed after September 30, 1988. The bill also imposes a floor stocks tax of $2.67 per pound on pipe tobacco removed before October 1, 1988, and held in inventory or in transit on October 1, 1988. The floor stocks tax is due and payable on November 14, 1988.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the tax rate is $0.45 per pound and the effective date for the tax and the floor stocks tax is January 1, 1989. The floor stocks tax is due and payable on February 14, 1989. Additionally, the conferees wish to clarify that the tobacco subject to this tax includes all types of tobacco "suitable" for use in a pipe, regardless of how packaged or labeled.

J. Other Revenue-Increase Provisions

1. Increase in penalty for bad checks

Present Law

A person who tenders to the Internal Revenue Service (IRS) a bad check (or money order not duly paid) in payment of any amount under the Internal Revenue Code is subject to a penalty equal to the greater of: (1) 1 percent of the amount of such check, or (2) $5 (or the amount of such check if less than $5). The penalty does not apply if the person tendered the check in good faith and with reasonable cause to believe that it would be duly paid.

House Bill

A person who tenders to the IRS a bad check (or money order not duly paid) in payment of any amount under the Internal Revenue Code is subject to a penalty equal to the greater of: (1) 2 percent of the amount of such check, or (2) $15 (or the amount of such check if less than $15). As under present law, the penalty would not apply if the person tendered the check in good faith and with reasonable cause to believe that it would be duly paid. The provision is effective for checks or money orders received by the IRS after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Pension reversions of qualified plan assets: temporary increase in excise tax

Present Law

A 10-percent excise tax is imposed on employer reversions from qualified plans (sec. 4980). Present law contains certain exemptions from the excise tax, for example, for certain transfers of reversions to an ESOP. The excise tax is required to be paid by the last day of the second month following the calendar quarter in which the reversion occurs.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the excise tax on reversions of assets from qualified plans is temporarily increased from 10 percent to 60 percent. Present-law exceptions to the excise tax continue to apply as under present law, but are not otherwise modified.

Under the Senate amendment, the excise tax is required to be paid by the end of the month following the month in which the reversion occurs.

The increase in the excise tax generally applies to reversions received after July 26, 1988, and before May 1, 1989. The acceleration of time for payment of the tax applies to reversions received on or after May 1, 1989.

The increase in the excise tax does not apply if a final order directing plan termination was entered by a court of competent jurisdiction and notice of such court-ordered termination was provided to participants before July 27, 1988.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the acceleration of the time for payment of the excise tax, except that the provision applies to reversions received after December 31, 1988. The conference agreement modifies the temporary increase in the excise tax in the Senate amendment to provide for a permanent increase in the excise tax from 10 to 15 percent. The increase is effective for reversions received after October 20, 1988, if notice of the intent to terminate the plan was not provided before October 21, 1988. The conferees do not intend any inference with respect to the issue of when a reversion is received for income and excise tax purposes.

The conferees intend that an employer is to be treated as providing notice of intent to terminate to employees if the employer has provided notice to substantially all employees by a specific date (such as through a mass mailing to employees by such date), even if some employees are not notified through an inadvertent failure of the employer. The conferees do not intend any inference with respect to whether notice has been provided for any other purpose.

3. Denial of deduction for certain residential telephone service

Present Law

No deduction is allowed for personal, living, or family expenses (sec. 262), such as expenses for personal use of a telephone in the taxpayer's residence.

Under present law, a taxpayer who uses the telephone in his or her residence for business or income-production purposes may deduct a proportionate part of the cost of local telephone service provided to the residence, subject to any applicable limitations on home office deductions or miscellaneous itemized deductions (secs. 162, 212, 280A, and 67).

House Bill

No deduction is allowed to an individual taxpayer for any charge (including any sales or excise taxes imposed on such charge) required to be paid by the taxpayer in order to obtain local telephone service with respect to the first telephone line in a taxpayer's residence (whether or not the taxpayer's principal residence). The provision does not affect the deductibility of charges for long-distance calls, nor does it affect the deductibility of charges for equipment rental, optional services offered by the telephone company (e.g., call waiting or call forwarding), or charges attributable to additional telephone lines to a taxpayer's residence other than the first telephone line.

The provision is effective for taxable years beginning after December 31, 1988.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

4. Information reporting by partnerships with tax-exempt partners

Present Law

Organizations that are exempt from Federal income tax are subject to tax on any unrelated trade or business income (secs. 511–514). Subject to specified exceptions, modifications, and computational rules, an activity of an otherwise tax-exempt organization generates gross income for purposes of the unrelated business income tax (UBIT) if (1) the income is derived from a trade or business, (2) the trade or business is regularly carried on by the organization, and (3) the conduct of the trade or business is not substantially related (aside from the organization's need for revenues or the use it makes of such revenues) to the organization's performance of its tax-exempt functions. Interest, dividends, and certain gains or losses from the sale of property may be subject to the UBIT if derived from debt-financed unrelated property.

If a partnership in which an exempt organization is a partner regularly carries on a trade or business that would constitute an unrelated trade or business if directly carried on by the exempt organization, the organization generally must include its share of the partnership's income and deductions from such business in computing its UBIT liability; also, special rules apply where the organization is a partner in a publicly traded partnership (sec. 512(c)).

Under present law, a partnership generally must furnish to each partner a statement reflecting such information required to be shown on the partnership's return as may be specified by Treasury regulations (sec. 6031(b)). The statement must set forth the partner's distributive share of partnership income, gain, loss deduction, or credit required to be shown on the partnership return, plus any additional information as provided by IRS forms or instructions that may be required to apply particular provisions of subtitle A of the Code to the partner with respect to items related to the partnership (Temp. Reg. sec. 1.6031(b)-1T). The present statute and regulations do not make an express reference to reporting by partnerships in which exempt organizations are partners of that portion of the organization's distributive share of partnership income that is subject to the UBIT.

The instructions for Schedule K–1 (Form 1065) require the partnership to identify whether the partner is an exempt organization.

Also, the partnership must attach a statement furnishing any other information needed by the partner to file its return that is not shown elsewhere on Schedule K-1. For example, the instructions state, "if there is a pension plan that is a partner, special information may be needed by that partner to properly file its tax return."

House Bill

No provision.

Senate Amendment

The Senate amendment modifies section 6031(b) to provide expressly that, in the case of any partnership regularly carrying on a trade or business (within the meaning of sec. 512(c)(1)), the partnership must furnish to the partners such information as necessary to enable each tax-exempt partner to compute its distributive share of partnership income or loss from such trade or business in accordance with section 512(a)(1), but without regard to the modifications described in paragraphs (8) through (15) of section 512(b).

Conference Agreement

The conference agreement follows the Senate amendment, with a modification clarifying that the provision is effective for taxable years beginning after December 31, 1988. The conferees believe that this express statutory provision relating to specific reporting of income subject to the UBIT will emphasize that the IRS should monitor and enforce the present-law reporting requirements and, where appropriate, should provide further guidance to partnerships through regulations or instructions as to how such information must be furnished. The conferees intend that information that must be furnished to tax-exempt partners under this provision is to be reflected by such organizations on Form 990 or Form 990-T in the manner prescribed by Treasury regulations or by the IRS instructions for such forms.

5. Application of wash sale rules to options

Present law

The wash sale provisions generally disallow the deduction of a loss on the sale or other disposition of shares of stock or securities if the taxpayer acquires or enters into a contract or option to acquire substantially identical stock or securities within a period beginning 30 days before the date of such sale or other disposition and ending 30 days after such date. The Tax Court recently held in *Gantner v. Commissioner*, 91 T.C. No. 47 (1988), that the wash sale rules do not apply to disallow losses sustained on the sales of stock options.

House Bill

No provision.

Senate Amendment

The wash sale rules are extended to apply to contracts or options to acquire stock or securities.

The provision would apply to any sale after the date of enactment of the provision, in taxable years ending after that date. No inference regarding the application of prior law is intended.

Conference Agreement

The conference agreement follows the Senate amendment with the following modifications.

The conferees clarify that the wash sale provisions are extended to contracts or options to sell stock or securities as well as contracts or options to acquire stock or securities. As is the case with the other provisions of the Senate amendment, no inference is intended as to prior law.

The Treasury is provided regulatory authority to except certain contracts or options to acquire or sell stock or securities from the wash sale rules. The Treasury may consider whether it is appropriate to provide exceptions from the wash sale rules for contracts subject to section 1256 of the Code or transactions subject to the straddle rules. In addition, the Treasury may issue regulations concerning when contracts or options to sell or acquire stock or securities will be considered substantially identical for purposes of the wash sale rules.

No inference regarding the application of prior law is intended.

6. Treatment of certain installment sales by nondealers

Present Law

The Omnibus Budget Reconciliation Act of 1987 provided special installment sale rules that apply to the sale of non-farm real property that is used in a taxpayer's trade or business or that is held for the production of rental income where the selling price of such real property is greater than $150,000. First, an interest charge is imposed on the tax that is deferred under the installment method to the extent attributable to the amount by which the deferred payments arising from all dispositions of such real property during any year exceeds $5 million. Second, if any indebtedness is secured directly by an installment obligation that arises out of the disposition of such property, the net proceeds of the secured indebtedness is treated as a payment on such installment obligation.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement extends the special installment sale rules contained in the 1987 Act to any property with a sales price in excess of $150,000, other than personal use property of an individual, property used or produced in the trade or business of farming, and timeshares and residential lots with respect to which interest is paid.

Thus, under the conference agreement, an interest charge is imposed on the tax that is deferred under the installment method to the extent attributable to the amount by which the deferred payments arising from all dispositions of such property during any year exceeds $5 million. In addition, if any indebtedness is secured directly by an installment obligation that arises out of the disposition of such property, the net proceeds of the secured indebtedness are treated as a payment on the installment obligation.

As under present law, in determining whether the sales price of property exceeds $150,000, all sales or exchanges that are part of the same transaction or series of transactions are treated as a single sale or exchange.

The provision applies to dispositions that occur after December 31, 1988, except that the provision does not apply to dispositions occurring on or before December 31, 1990, which are pursuant to (1) a binding written contract that was in effect on October 21, 1988, and at all times thereafter until the disposition occurred, or (2) a letter of intent or approval by the board of directors or shareholders of either party to the transaction, in effect on October 21, 1988.

V. OTHER SUBSTANTIVE REVENUE PROVISIONS

A. Individual Provisions

1. Treatment of certain payments to colleges for right to purchase athletic tickets

Present Law

Pursuant to IRS guidelines, if a payment to or for a college (e.g., to the college's athletic scholarship program) entitles the payor to purchase seating at the college's athletic stadium, the payment is not deductible as a charitable contribution if such tickets would not have been readily available to the taxpayer without making the payment (Rev. Rul. 86-63, 1986-1 C.B. 6, superseding Rev. Rul. 84-132, 1984-2 C.B. 55).

House Bill

If a taxpayer makes a payment to or for the benefit of a college or university that would be deductible as a charitable contribution but for the fact that the taxpayer thereby receives (directly or indirectly) the right to purchase seating at an athletic event in the institution's athletic stadium, 80 percent of such payment is treated as a charitable contribution. This rule applies whether or not the tickets would have been readily available to the taxpayer without making the payment.

As under present law, no amount paid for the actual purchase of tickets is deductible as a charitable contribution. The 80-percent deduction rule in the provision does not apply if the taxpayer receives tickets or seating (rather than the right to purchase tickets) in return for the payment.

The provision applies to amounts paid in taxable years beginning after December 31, 1983 (i.e., beginning with the year in which the original IRS ruling on this issue was published).

Senate Amendment

The Senate amendment is the same as the House bill, except with respect to the effective date. The Senate amendment waives the statute of limitations for closed years (beginning after 1983) if the taxpayer files a refund claim within one year after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Nonrecognition of gain on sale of old residence where one spouse dies before occupying new residence

Present Law

In general, a married couple filing jointly may defer recognition of gain on the sale of their principal residence if the sales price of the old residence is reinvested in a new principal residence within a specified period of time (sec. 1034). This provision for nonrecognition of gain does not apply if one spouse dies after the date of sale of the old residence and before the date of purchase of the new residence.

House Bill

The present-law rule on nonrecognition of gain applies where the surviving spouse purchases a new principal residence within the specified period of time. This provision applies with respect to sales and exchanges of old residences after December 31, 1984.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Full deductibility of meals provided to employees on certain vessels or drilling rigs

Present Law

An otherwise allowable business deduction for any expense for food or beverages (including employer-provided meals to employees) is reduced by 20 percent, subject to certain exceptions (sec. 274(n)).

House Bill

Vessels

The percentage reduction rule does not apply to an otherwise allowable deduction for expenses of food or beverages that (1) are required by Federal law (46 U.S.C. sec. 10303) to be provided to crew members of a commercial vessel, or (2) are provided to crew members of a commercial vessel operating on the Great Lakes, the St. Lawrence Seaway, or the U.S. inland waterways that is of a kind that would be required by Federal law to provide food or beverages to crew members if operated at sea. (Thus, for example, the provision for full deductibility would not apply with respect to fishing boats or foreign vessels operating on the inland waterways.) However, the present-law percentage reduction rule continues to apply with respect to expenses of food or beverages provided to crew members of vessels the predominant use of which is for luxury water transportation, such as cruise ships, passenger liners, or yachts.

This provision is effective for taxable years beginning after December 31, 1988.

Drilling rigs

The percentage reduction rule does not apply to an otherwise allowable deduction for expenses of food or beverages that are provided by an employer on an oil or gas platform or drilling rig if such platform or rig is located either offshore or in the United States north of 54 degrees north latitude. This provision is effective for taxable years beginning after December 31, 1987.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification also exempting from the percentage reduction rule an otherwise allowable deduction for expenses of food or beverages that are provided by an employer at a support camp that is in proximity to, and that is integral to, an oil or gas drilling rig if the platform or rig is located in the United States north of 54 degrees north latitude.

4. Treatment of certain innocent spouses

Present Law

Pursuant to the Tax Reform Act of 1984, a spouse filing a joint return is relieved of liability if (1) there is a substantial understatement of tax attributable to a grossly erroneous item of the other spouse; (2) the spouse establishes that in signing the return he or she did not know that there was a substantial understatement; and (3) taking into account all the facts and circumstances, it is inequitable to hold the spouse liable for the deficiency in tax attributable to the understatement (sec. 6013(e)).

House Bill

If (1) on a joint return filed before January 1, 1985, there was an understatement attributable to disallowed deductions of the other spouse the amount of which exceeded the taxable income shown on the return, (2) the spouse establishes that in signing the return he or she did not know (or have reason to know) that there was such an understatement, (3) the marriage terminated, and (4) the net worth of the spouse immediately following the termination of the marriage was less than $10,000, then the spouse is relieved of liability for tax (including interest, penalties, and other amounts) for the year to the extent the liability is attributable to the understatement. A refund is allowed notwithstanding any law or rule of law if a refund claim is filed within one year of the date of enactment, but no interest is payable for any period prior to the date of enactment.

The provision applies with respect to joint returns filed before January 1, 1985 (the effective date of the 1984 Act provision relating to innocent spouses).

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

5. Interim treatment of certain amounts awarded to Christa McAuliffe Fellows

Present Law

Under the Christa McAuliffe Fellowship Program, the Federal Government awards fellowships annually to outstanding teachers (20 U.S.C. sec. 1113). The award may be used only for an education improvement project approved by the Department of Education. Project purposes may include (1) development of special innovative programs, (2) consultation with or assistance to other school districts, (3) model teacher programs and staff development, or (4) sabbaticals for study, research, or academic improvement. Under the program as currently structured, checks made out to the teacher are issued on the basis of monthly budget submissions showing amounts needed for carrying out the approved project.

The Federal statute establishing the McAuliffe Fellowship Program did not include rules for the Federal income tax treatment of program awards. In general, nonscholarship awards to individuals are includible in the recipient's gross income (sec. 74).

House Bill

The amount of a Christa McAuliffe Fellowship that is expended, in accordance with the terms of the award, on an approved school project for the benefit and use of a school or school system is to be treated as an award to the school, and hence is not to be includible in the teacher's gross income. Any amount retained or used directly or indirectly for the personal benefit of the teacher, such as for a sabbatical trip or as compensation for services in connection with the project, is includible in the teacher's gross income.

This provision applies to award amounts received prior to July 1, 1990.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

6. Election by parent to claim unearned income of certain children on parent's return

Present Law

The unearned income of a child under the age of 14 in excess of $1,000 is taxed to the child at the top marginal rate of his or her parents. A dependent child with any unearned income must file a tax return if his or her total income exceeds $500.

House Bill

No provision.

Senate Amendment

A parent may elect to include unearned income of a child on the parent's income tax return if the income of the child is less than $5,000 and consists entirely of interest, dividends, or Alaska Permanent Fund dividends. The election is not available if estimated tax payments for the taxable year are made in the child's name and TIN (social security number).

A parent who makes the election under the provision must include in income an amount equal to the excess of the child's unearned income over the lesser of $500 or the taxable portion of such income. The Treasury Department is authorized to issue such regulations as are necessary to carry out the purposes of the provision, including those governing the placement of the election on the return.

The provision is effective for taxable years beginning after December 31, 1988.

Conference Agreement

The conference agreement follows the Senate amendment with the following modifications.

Under the conference agreement, a child under the age of 14 is treated as having no gross income and is not required to file an income tax return if (1) the child has gross income only from interest and dividends (including Alaska Permanent Fund dividends), (2) such income is between $500 and $5,000, (3) no estimated tax payments for the year are made in the name and TIN of the child, (4) the child is not subject to backup witholding, and (5) the parent makes the election described below.

A parent electing under the provision must include the gross income of the child in excess of $1,000 in his or her income for the taxable year. In addition, the parent must report an additional tax liability with his or her return equal to the lesser of (1) $75 or (2) 15 percent of the excess of the child's income over $500. Finally, certain interest from specified private activity bonds is treated as an item of tax preference of the parent.

7. Above-the-line deduction for jury duty pay that employee must surrender to employer

Present Law

If an employer requires its employee to surrender to the employer amounts received as jury duty pay, in return for continuing the employee's normal salary while on jury service, the amount of surrendered jury pay is deductible only if the employee itemizes deductions and only to the extent exceeding two percent of the employee's adjusted gross income (sec. 67).

House Bill

No provision.

Senate Amendment

An above-the-line deduction is allowed for the amount of jury duty pay surrendered by an employee to his or her employer, in return for the employer's payment of compensation to the employee for the period of jury service. (Thus, where the provision applies, the deduction is available to both itemizers and nonitemizers, and is not subject to the two-percent floor.) This provision is effective for taxable years beginning after December 31, 1986 (the effective date of the 1986 Act provision imposing the two-percent floor).

Conference Agreement

The conference agreement follows the Senate amendment.

8. Medical expense deduction for costs of service animals to assist handicapped individuals

Present Law

IRS rulings specifically provide that amounts paid to acquire, train, and maintain a dog for the purpose of assisting a blind or deaf taxpayer are eligible for the itemized deduction for medical expenses (Rev. Rul. 55-261, 1955-1 C.B. 307; Rev. Rul. 68-295, 1968-1 C.B. 92).

House Bill

No provision.

Senate Amendment

The legislative history of the Senate amendment clarifies that costs incurred with respect to a dog or other service animal in order to assist individuals with any type of physical disabilities are eligible for the medical expense deduction. This provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

9. Medical expense deduction for certain radon mitigation costs

Present Law

Taxpayers who itemize deductions are allowed to deduct medical expenses of the taxpayer, spouse, or a dependent, to the extent that such expenses exceed 7.5 percent of adjusted gross income (sec. 213). The cost of a permanent improvement to a residence may be deductible as a medical expense if the expenditure is directly related to medical care, but only for any portion of the cost that exceeds the increased value of the property attributable to the improvement.

House Bill

No provision.

Senate Amendment

Specified types of home improvement costs incurred to mitigate radon gas exposure are treated as medical care expenses eligible for the section 213 deduction. This provision applies only if the taxpayer shows, through measurements taken by a State or by a person approved by the Environmental Protection Agency (EPA), that radon levels in the taxpayer's home exceeded the level of safety recommended by the EPA. The full amount of such specified types of radon mitigation expenditures is eligible for the medical expense deduction without regard to whether such expenditures increase the value of the home.

The specified types of home improvements for mitigating radon gas exposure are: (1) sub-slab ventilation; (2) drain-tile ventilation; (3) block-wall ventilation; and (4) sump ventilation. In addition, Treasury regulations may provide that installation of air heat exchangers and air filtration systems as well as other techniques may be eligible for the deduction, if the taxpayer shows that one of the four specified techniques listed above failed to reduce the concentration of radon gas in the air of the residence to the level of safety recommended by the EPA.

The provision is effective for taxable years beginning after December 31, 1987.

Conference Agreement

The conference agreement follows the House bill.

10. Education savings bonds and modification of student dependency exemption

a. Education savings bonds

Present Law

An exclusion from gross income, or deferral of taxation, for interest or other income is not allowable because the taxpayer uses the income specifically for educational expenses.

Taxation of interest accruals on U.S. Series EE savings bonds may be deferred by cash-basis taxpayers until transfer of ownership or redemption of the bonds.

House Bill

No provision.

Senate Amendment

Interest income earned on a qualified U.S. Series EE savings bond is excluded from gross income, if, instead of being redeemed, the bond is transferred to an eligible educational institution as payment of qualified educational expenses, i.e., tuition and required fees, for a taxpayer, or taxpayer's spouse or dependents. The amount of exclusion allowed for a taxable year is the lesser of (1) the amount that otherwise is includible in gross income by reason of such transfer, or (2) the amount of such higher education expenses.

The exclusion is phased out for a taxpayer with adjusted gross income (AGI) of $60,000 or more for the taxable year; no amount is excludible by a taxpayer whose AGI is $80,000 or more. For a taxpayer with AGI between $60,000 and $70,000, 67 percent of the eligible amount is excludible; for AGI between $70,000 and $80,000, 34 percent of the eligible amount is excludible. In the case of a married individual filing separately, the phaseout amounts are one-half of those described. The phase-out amounts are indexed in calendar years after 1988.

With respect to a taxpayer who is a dependent of another taxpayer, the phaseout is applied by taking into account the AGI of both taxpayers.

Present law is amended to allow (1) transfer of a U.S. savings bond to an eligible educational institution and (2) redemption of such bond by such institution for the educational purposes of this provision.

An eligible educational institution is defined in the Higher Education Act of 1965 (sec. 1201(a) or 481(a)), or in the Carl D. Perkins Vocational Education Act (subparagraph (C) or (D) of sec. 521(3)).

The provision is effective for transfers of qualified U.S. savings bonds issued after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with the following changes.

The exclusion from gross income of interest on U.S. Series EE savings bonds is available only for individuals who have purchased, after having attained age 24, and are sole owners of the bonds, or who own such bonds jointly with their spouse. The exclusion is not available to an individual who is the owner of a Series EE bond which was purchased by another individual, other than a spouse. Under this rule, interest on bonds purchased by an individual to be redeemed in (say) 10 years when a dependent of the individual attends a college is eligible for the exclusion. However, the exclusion will not be allowable if bonds are purchased by a parent and put in the name of the child or another dependent of the taxpayer, or if bonds are purchased by any individual who is under age-24 at the time of purchase.

Savings bonds are to be redeemed by the owner, rather than being transferred to the educational institution. If the aggregate redemption amount, i.e., principal plus interest, of all Series EE bonds redeemed by the taxpayer during the taxable year does not exceed the amount of the student's qualified educational expenses, all interest for the year on the bonds is excludible subject to the AGI phaseout; for example, when the redemption amount is $8,000 ($4,000 principal and $4,000 accrued interest) and qualified educational expenses are $9,500, the redemption amount exceeds the qualified educational expenses and all $4,000 interest in the redemption amount is excludible from income. If the redemption amount exceeds the qualified educational expenses, the amount of excludible interest is reduced on a pro rata basis, i.e., the ratio of qualified educational expenses to the sum of principal and interest on all Series EE bonds redeemed during the taxable year. For example, if the redemption amount is $8,000, consisting of $4,000 each principal and interest, and qualified educational expenses are $6,000, the ratio of expenses to redemption amount is 75 percent, and $3,000 of the interest received in the course of redemption is excludible from income.

Qualified educational expenses mean tuition and required fees net of scholarships, fellowships, employer provided educational assistance (sec. 127), and other tuition reduction amounts. The expenses must be incurred by the taxpayer, spouse, or dependent during the year of redemption. Such expenses do not include expenses with respect to any course or other education involving sports, games, or hobbies, other than as part of a degree or certificate granting program.

Eligible educational institutions are defined in sec. 1201(a) and 481(a)(1) (C) and (D) (i.e., nursing schools) of the Higher Education Act of 1965, as in effect on October 21, 1988, and in the Carl D. Perkins Vocational Education Act (subparagraph (C) or (D) of sec. 521(3)), as in effect on October 21, 1988. An eligible educational institution does not include proprietary institutions.

The phaseout ranges are modified. For joint returns, the phaseout range is for modified AGI from $60,000 to $90,000, and from $40,000 to $55,000 for single taxpayers and heads of households. Married taxpayers who file separate returns are not eligible for the exclusion. Modified AGI means the sum of the adjusted gross income of the taxpayer for the taxable year, the partial inclusion of social security and tier 1 railroad retirement benefits (sec. 86), the adjustments for contributions of retirement savings (sec. 219), and adjustments with respect to limitations of passive activity losses and credits (sec. 469), and, without regard to this section, the gross income earned by citizens or residents of the United States living abroad (sec. 911), and income from sources within Guam, American Samoa, the Northern Mariana Islands, and Puerto Rico (secs. 931 and 933).

The phaseout rate for the exclusion is applied gradually over the income phaseout range, as is the case with other income phaseouts under present law.

The amounts of AGI that determine the phaseout range are indexed beginning in 1990. Such adjustments will be rounded to the nearest $50.

The conference agreement authorizes the Secretary of the Treasury to prescribe recordkeeping, information reporting and bond redemption procedures with regard to the responsibilities of both the Bureau of Public Debt and the Internal Revenue Service. Such authority includes modifying the forms that are filled out when bonds are redeemed to provide reporting specifically of both principal and interest components of the redemption amount, an indication that the redemption amount is intended for payment of qualified educational expenses, and the issuance date of the bond. The regulations also may prescribe appropriate requirements for substantiation of the amount of qualified educational expenses incurred during the year. The Secretary is also directed to take such steps as may be necessary to make the general public aware of this program.

The amendments made by provision apply to taxable years beginning after December 31, 1989. The term qualified United States Series EE savings bond means any United States savings bond issued after December 31, 1989, at discount under section 3105 of title 31, United States Code and to interest earned on bonds issued on and after January 1, 1990, to the purchaser-owner of the bonds. The exclusion is not available for any bonds which might be obtained as part of a tax-free rollover of matured Series E savings bonds into Series EE savings bonds.

Under the conference agreement, the Treasury Department, after consultation with the Department of Education, shall conduct a study of the feasibility of utilizing stamp or similar programs to encourage and facilitate savings by parents toward purchase of Series EE bonds eligible for exclusion under the provision. The Treasury Department shall submit the results of the study, together with any recommendations as deemed appropriate, to the taxwriting committees by December 31, 1989.

b. Dependency exemption for certain students

Present Law

A taxpayer generally may not claim a dependency exemption for a dependent whose gross income for the year exceeds the exemption amount ($1,950 in 1988). However, this gross income test does not apply if the dependent is (1) a child of the taxpayer and (2) a full-time student at a qualified educational organization, regardless of the student's age.

House Bill

No provision.

Senate Amendment

A taxpayer may not claim a dependency exemption for a dependent who is a student who has attained 24 years of age before the close of the calendar year, unless the child's gross income for the year is less than the exemption amount. If the parent cannot claim an exemption under this rule, the child may claim an exemption on his or her own return.

The provision is effective for taxable years beginning after December 31, 1989.

Conference Agreement

The conference agreement follows the Senate amendment with a change in the effective date which applies the provision to taxable years beginning after December 31, 1988.

c. Prepaid tuition plans

Present Law

No provision.

House Bill

No provision.

Senate Amendment

Benefits similar to those allowable in the provision for educational savings bonds are made available with regard to the exclusion of income used to pay tuition and required fees to certain prepaid tuition plans which have been established by several States.

Conference Agreement

The conference agreement follows the House bill.

11. Exclusion of gain on sale of principal residence by certain incapacitated taxpayers age 55 or over

Present Law

In general, a taxpayer may exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale, and (2) has used the residence as a principal residence for three or more years of the five years preceding sale of the residence (sec. 121).

House Bill

No provision.

Senate Amendment

The Senate amendment provides that a taxpayer is treated as meeting the required use rule (three out of the five years preceding sale of the residence) if during the five-year period the taxpayer becomes physically or mentally incapable of self care and (1) owns and uses the residence for at least one year and (2) then during any time within such 5-year period the taxpayer owns the property and resides in a facility (including a nursing home) licensed by a State or political subdivision to care for individuals who have become mentally or physically incapable of self-care.

The provision applies to sales of residences occurring after September 30, 1988.

Conference Agreement

The conference agreement follows the Senate amendment.

12. Business use of automobiles by rural mail carriers

Present Law

A deduction is allowable for business use of an automobile equal to the business portion of the taxpayer's actual expenses for operating and maintaining the vehicle, plus depreciation. Alternatively, the amount of the deduction may be computed by multiplying a standard mileage rate, specified by the IRS, by the number of miles actually driven for business purposes. For 1988, the standard rate for the first 15,000 miles of business use of an automobile that is not fully depreciated is 24 cents per mile.

House Bill

An employee of the U.S. Postal Service may compute his or her deduction for business use of an automobile in performing services involving the collection and delivery of mail on a rural route by using, for all such business use mileage, 150 percent of the standard mileage rate that applies to the first 15,000 miles of business use of an automobile that is not fully depreciated. However, this computation method cannot be used if the taxpayer claimed depreciation deductions for the automobile for any taxable year beginning after December 31, 1987.

This provision applies to taxable years beginning after December 31, 1987.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

B. Accounting/Agriculture Provisions

1. Repeal uniform capitalization rules for free-lance authors, photographers, and artists

Present Law

In general, uniform cost capitalization rules apply to the production of all tangible personal property and to the purchase and holding of property for resale. For purposes of the uniform capitalization rules, tangible personal property includes a film, sound recording, video tape, book, or similar property. The Internal Revenue Service has provided an elective simplified method for deducting business expenses of authors, photographers, artists, and other similarly situated persons who incur expenses in producing creative properties. Under this method, eligible taxpayers generally may deduct 50 percent of their business expenses in the year in which incurred and 25 percent in each of the two succeeding years.

House Bill

The House bill exempts from the application of the uniform capitalization rules any otherwise deductible expense that is paid or incurred by an individual engaged in the business of being a writer, photographer, or artist. The exemption applies only to an individual whose personal efforts create or may reasonably be expected to create a literary manuscript, musical composition, dance score, photograph, photographic negative or transparency, picture, painting, sculpture, statue, etching, drawing, cartoon, graphic design, or original print edition.

In determining whether an expense is paid or incurred in the business of being an artist, the originality and uniqueness of the item created (or to be created) and the predominance of aesthetic value over utilitarian value of the item created (or to be created) are to be taken into account. Thus, for example, any expense that is paid or incurred in producing jewelry, silverware, pottery, furniture, and other similar household items generally is not to be considered as being paid or incurred in the business of an individual being an artist.

The exception to the uniform capitalization rules for otherwise deductible expenses paid or incurred by an individual engaged in the business of being a writer, photographer, or artist does not apply to any expense paid or incurred by an individual in the individual's capacity as an employee. In addition, the exception does not apply to any expense that is related to printing, photographic plates, motion picture films, video tapes, or similar items.

Expenses paid or incurred by a personal service corporation that directly relate to the activities of a qualified employee-owner qualify for the exception to the uniform capitalization rules to the extent that the expenses would qualify if paid or incurred directly by the employee-owner.

The provision is effective as if included in the Tax Reform Act of 1986. An eligible taxpayer who elected the simplified method provided by the Internal Revenue Service for any taxable year ending before the date of enactment may either (1) apply the provision of the bill for each year that an election was in effect by filing an amended return for such year, or (2) apply the provision of the bill for the first taxable year ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Repeal uniform capitalization rules for certain producers of animals; depreciation of certain farm property

a. Uniform capitalization rules for certain producers of animals

Present Law

In general, uniform cost capitalization rules apply to the production of property and to the purchase and holding of property for resale. In the case of any animal that is produced by a taxpayer in a farming business, the uniform capitalization rules apply only if (1) the animal has a preproductive period of more than two years or (2) the taxpayer engaged in the farming business is a corporation, partnership or tax shelter that is required to use an accrual method of accounting.

The Internal Revenue Service has provided an elective simplified method for capitalizing the costs of raising female cattle that are to be used principally for purposes of breeding ("beef cattle") or for purposes of producing milk to be sold for consumption ("dairy cattle"). Under this method, taxpayers other than those required to use an accrual method of accounting generally may capitalize a total of $340 for each beef cow, or $540 for each dairy cow, over a period of three years beginning with the year in which the cow is born.

House Bill

The House bill exempts from the application of the uniform capitalization rules otherwise deductible expenses that are incurred by a taxpayer in connection with the production of animals in any farming business other than a farming business of a corporation, partnership or tax shelter that is required to use an accrual method of accounting. The provision applies to costs incurred after December 31, 1988, in taxable years ending after such date.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

b. Treatment of single-purpose agricultural or horticultural structures

Present Law

Single-purpose agricultural or horticultural structures are assigned a 7-year recovery period under modified ACRS. The Treasury Department may not assign a longer recovery period to single-purpose agricultural or horticultural structures that are placed in service before January 1, 1992.

House Bill

Single-purpose agricultural structures that are used for housing, raising, and feeding poultry are assigned a recovery period of 8 years, and all other single-purpose agricultural or horticultural structures are assigned a recovery period of 12 years. As under present law, the Treasury Department is prohibited from assigning a longer recovery period to such structures that are placed in service before January 1, 1992.

The provision generally applies to structures placed in service after December 31, 1988. An exception is provided for property placed in service before January 1, 1990, if such property is under construction or reconstruction by the taxpayer on July 14, 1988, or if such property is acquired pursuant to a binding written contract in existence before July 14, 1988.

Senate Amendment

The Senate amendment is the same as the House bill, except that all single-purpose agricultural or horticultural structures are assigned a ten-and-one-half year recovery period.

Conference Agreement

The conference agreement follows the House bill, except that the agreement assigns all single-purpose agricultural or horticultural structures a ten-year recovery period.

c. Treatment of property used in a farming business

Present Law

Property used in a farming business is assigned various recovery periods in the same manner as other business property. In general, the applicable depreciation method is the same for property used in a farming business as property with the same recovery period used in other businesses. For property with recovery periods of less than 15 years, this method is generally the 200-percent declining balance method switching to the straight-line method to maximize the depreciation allowance. Under a special accounting rule, certain taxpayers engaged in the business of farming who elect to deduct preproductive period expenditures are required to depreciate all farming assets on the alternative depreciation system (*i.e.*, using longer recovery periods and the straight-line method).

House Bill

For property that is used in the trade or business of farming and which under present law is eligible for the 200-percent declining balance method, the bill provides that the applicable depreciation method is the 150-percent declining balance method switching to the straight-line method at a time to maximize the depreciation allowance, except that taxpayers who elect to deduct preproductive period expenses must continue to use the alternative depreciation system.

The provision generally applies to property placed in service after December 31, 1988. An exception is provided for property placed in service before July 1, 1989, if such property is under construction or reconstruction by the taxpayer on July 14, 1988 or if such property is acquired pursuant to a binding written contract in existence before July 14, 1988.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Election of producers of pistachio nuts to deduct preproductive period costs currently

Present Law

In general, uniform cost capitalization rules apply to the production of property and to the purchasing and holding of property for resale. In the case of any plant or animal that is produced by a taxpayer in a farming business, the uniform capitalization rules apply only if (1) the plant or animal has a preproductive period of more than two years or (2) the taxpayer engaged in the farming business is a corporation, partnership or tax shelter that is required to use an accrual method of accounting.

Taxpayers engaged in a farming business may elect to deduct currently the costs relating to the production of farm products. If this election is made, a portion of the gain from the disposition of the farm product is taxed as ordinary income and all farm assets placed in service in any taxable year for which an election is in effect are subject to the alternative depreciation system. The election to deduct currently preproductive period costs may not be made (1) by corporations, partnerships or tax shelters that are required to use an accrual method of accounting or (2) with respect to costs incurred in the planting, cultivation, maintenance, or development of pistachio trees.

House Bill

Under the House bill, taxpayers that are not required to use an accrual method of accounting may elect to deduct currently costs incurred in the planting, cultivation, maintenance, or development of pistachio trees. If this election is made, gain from the disposition of pistachio nuts is taxed as ordinary income to the extent of prior deductions that would have been capitalized but for the election. In addition, all farm assets placed in service in any taxable year for which an election is in effect are subject to the alternative depreciation system.

The provision is effective as if included in the Tax Reform Act of 1986.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Treatment of certain trees and vines

Present Law

Depreciation recovery periods, for purposes of the modified accelerated cost recovery system, are generally determined by reference to the Asset Depreciation Range ("ADR") class life of the asset. Currently, it is unclear whether trees and vines are classified as land improvements under the ADR system (with a midpoint life of 20 years) or have no class life. Under modified ACRS, the depreciation deductions for property with an ADR midpoint life of 20 years generally are calculated using a 15-year recovery period and the 150% declining balance method with a switch to straight line at a time to maximize the depreciation deduction. Property, which is not residential rental or nonresidential real property and which does not have an ADR class life, generally uses the 200% declining balance method with a seven-year recovery period, under modified ACRS.

House Bill

No provision.

Senate Amendment

For purposes of modified ACRS, the amendment provides that the depreciation deduction for trees or vines bearing fruit or nuts will be calculated using the straight line method over a ten-year recovery period.

The provision is effective for property placed in service after December 31, 1988.

Conference Agreement

The conference agreement follows the Senate amendment. In addition, because trees or vines bearing fruit or nuts will now be specifically assigned to a recovery class for purposes of modified ACRS, such property will be assigned a class life of 20 years for ADR purposes. The conferees intend that no inference should be drawn from this provision concerning the appropriate ADR classification or recovery period for trees and vines placed in service prior to January 1, 1989.

5. Treatment of livestock sold on account of drought

Present Law

A cash method taxpayer whose principal trade or business is farming and who is forced to sell certain livestock due to drought conditions may elect to include any income from the sale of the livestock in the taxable year following the taxable year of the sale. This one-year elective deferral of income is available only if the livestock would not have been sold in the taxable year but for the drought and the drought conditions resulted in the area being designated as eligible for Federal assistance. The election generally does not apply to cattle, horses, and other livestock held for draft, breeding, dairy or sporting purposes.

House Bill

No provision.

Senate Amendment

The one-year elective deferral of income is extended to cattle, horses, and other livestock held for draft, breeding, dairy or sporting purposes. The provision applies to sales and exchanges occurring after December 31, 1987.

Conference Agreement

The conference agreement follows the Senate amendment.

6. Treatment of certain payments received as a result of crop losses due to drought conditions

Present Law

A cash method taxpayer who receives insurance proceeds as a result of the destruction of, or damage to, crops may elect to include the proceeds in income for the taxable year following the year in which the destruction or damage occurs if, under the taxpayer's practice, income from such crops would have been included for a year following the year in which the destruction or damage occurred. For this purpose, payments received under the Agricultural Act of 1949, as amended, as a result of the destruction of, or damage to, crops caused by drought, flood or other natural disaster or the inability to plant crops because of such natural disaster are treated as insurance proceeds received as a result of the destruction of, or damage to, crops.

House Bill

No provision.

Senate Amendment

Payments received under Title II of the Disaster Assistance Act of 1988 (P.L. 100-387) are treated in the same manner as payments received under the Agricultural Act of 1949. The provision applies to payments received before, on, or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Treatment of certain pledged installment obligations

Present law

The Revenue Act of 1987 provided special rules that apply to any installment obligation that arises out of the sale of non-farm real property that is used in a taxpayer's trade or business or that is held for the production of rental income where the selling price of the real property exceeds $150,000 (a "nondealer real property installment obligation"). Under these rules, if any indebtedness is secured directly by a nondealer real property installment obligation, the net proceeds of the secured indebtedness are treated as a payment on such installment obligation. This special rule generally applies to nondealer real property installment obligations that are pledged as security for a loan after December 17, 1987.

House Bill

Under the House bill, the special rule that treats the net proceeds of an indebtedness as payment on a nondealer real property installment obligation does not apply to a pledge of a nondealer real property installment obligation after December 17, 1987, to secure an indebtedness if the indebtedness is incurred to refinance indebtedness that (1) was outstanding on December 17, 1987, and (2) was secured by the nondealer real property installment obligation on such date and at all times thereafter until the refinancing occurred. This exception does not apply to the extent that the principal amount of the indebtedness resulting from the refinancing exceeds the principal amount of the refinanced indebtedness immediately before the refinancing. For purposes of the exception, a refinancing attributable to the creditor's calling of indebtedness is treated as a continuation of the indebtedness if the refinancing is provided by a person other than the creditor or a person related to the creditor and the refinancing otherwise qualifies for the exception.

The provision is effective as if included in the Revenue Act of 1987.

Senate Amendment

The Senate amendment is generally the same as the House bill, except that the refinancing of an indebtedness that was outstanding on December 17, 1987, and that was secured by a nondealer real property installment obligation on such date is to be treated as a continuation of the indebtedness only if (1) the taxpayer is required by the creditor to refinance the indebtedness, and (2) the refinancing is provided by a person other than the creditor or a person related to the creditor. In addition, if the term of the indebtedness resulting from the refinancing exceeds the term of the refinanced indebtedness, upon the expiration of the term of the refinanced indebtedness as in effect before the refinancing, the outstanding balance of the indebtedness resulting from the refinancing is to be treated as a payment on any installment obligation that secures such indebtedness.

Conference Agreement

The conference agreement follows the House bill.

8. Treatment of stock held in trust in determining whether certain corporations may use the cash method of accounting

Present Law

Qualified personal service corporations are excepted from the general rule denying the use of the cash method of accounting to a C corporation or a partnership with a C corporation as a partner. A qualified personal service corporation is a corporation that satisfies both a function test and an ownership test. The ownership test is satisfied if substantially all (i.e., 95 percent or more) of the value of the outstanding stock is owned, directly or indirectly, by (1) employees performing services for the corporation in connection with the qualified services performed by the corporation, (2) retired employees who performed such services for the corporation, (3) the estate of any employee or retired employee, or (4) any other person who acquired stock by reason of the death of an employee or retired employee (for the two-year period beginning with the death of the employee or retired employee).

In determining whether a corporation satisfies the ownership test, indirect ownership of stock is taken into account only if stock is owned indirectly through one or more partnerships, S corporations, or qualified personal service corporations. Stock that is owned by a partnership, S corporation, or qualified personal service corporation is considered to be owned by its owners in the same proportion as their ownership of the partnership, S corporation, or qualified personal service corporation.

House Bill

The House bill requires the Treasury Department to issue regulations that provide to what extent stock owned by non-grantor trusts is to be treated as indirectly owned by the beneficiaries of the trust in determining whether the ownership test is satisfied. The provision is effective as if included in the Tax Reform Act of 1986.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Pension and Employee Benefit Provisions

1. Employee benefit nondiscrimination rules for church plans and cafeteria plans

Present Law

Church plans.—Under present law, all statutory employee benefit plans maintained by all employers are subject to the nondiscrimination requirements of section 89.

Cafeteria plans.—Under present law, life insurance that is funded prior to retirement under a cafeteria plan but provided after retirement is tested for discrimination when provided.

House Bill

Church plans.—No provision.

Cafeteria plans.—No provision.

Senate Amendment

Church plans.—The Senate amendment provides that the nondiscrimination requirements of section 89 do not apply to statutory employee benefit plans maintained by a church for church employees. For purposes of this provision, the definition of a church is the same definition that applies for purposes of exclusion from FICA taxes (sec. 3121(w)(3)). Thus, the term "church" includes (1) a convention or association of churches, (2) an elementary or secondary school that is controlled, operated, or principally supported by a church or by a convention or association of churches, and (3) any church-controlled tax-exempt organization that does not receive substantial support from governmental sources or sales of goods or services.

The provision is effective as if included in the Tax Reform Act of 1986.

Cafeteria plans.—Under the Senate amendment, post-retirement life insurance funded under a cafeteria plan is tested for discrimination when it is funded based on the amount of life insurance that could at that time be purchased (assuming sec. 79(c) costs) with the cafeteria plan elective contributions.

The provision is effective as if included in the Tax Reform Act of 1986.

Conference Agreement

Church plans.—The conference agreement follows the Senate amendment.

Cafeteria plans.—The conference agreement follows the Senate amendment.

2. Eligible deferred compensation plans: modifications to section 457

Present Law

Under present law, unfunded deferred compensation plans maintained by a State or local government or by a nongovernmental

tax-exempt organization is subject to certain special rules (sec. 457). In Notice 88-68, the IRS announced that section 457 does not apply to bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, and death benefit plans. The Reform Act extended section 457 to nongovernmental tax-exempt organizations.

In Notice 88-98, the IRS announced that section 457 does not apply to compensation deferred under a written, nonqualified, nonelective deferred compensation plan that was in existence on December 31, 1987, and that is maintained pursuant to one or more collective bargaining agreements, until the earlier of (1) the effective date of any material modification to such nonelective plan (other than modifications entered into on or before December 31, 1987, to agreements entered into on or before such date), or (2) January 1, 1991.

House Bill

The House bill repeals the provision in the Reform Act extending section 457 to nongovernmental tax-exempt organizations, and codifies IRS Notice 88-68. In addition, the House bill provides that section 457 does not apply to certain nonelective deferred compensation deferred pursuant to agreements in effect on July 14, 1988, and directs the Treasury Department to perform a study regarding the tax treatment of deferred compensation paid by State and local governments and tax-exempt organizations.

In general, the House bill provision is effective for taxable years beginning after December 31, 1987. The repeal of the extension of section 457 to nongovernmental tax-exempt organizations is effective as if included in the Reform Act.

Senate Amendment

The technical corrections provisions of the Senate amendment includes a provision codifying IRS Notice 88-68.

The Senate amendment provision is effective with respect to taxable years beginning after December 31, 1978.

Conference Agreement

The conference agreement follows the House bill with respect to the codification of IRS Notice 88-68, the Treasury Department study, and the grandfather rule for nonelective deferred compensation under governmental plans for amounts deferred under agreements in effect on July 14, 1988. In addition, the conference agreement provides that this grandfather does not cease to apply merely because of a modification to the agreement prior to January 1, 1989, which does not increase benefits for participants in the plan.

The conference agreement also provides a grandfather for nonelective compensation deferred under a plan in effect on December 31, 1987, and maintained pursuant to one or more collective bargaining agreements. This grandfather is the same as the grandfather provided in IRS Notice 88-98, except that the grandfather does not expire on January 1, 1991. Thus, the same conditions that apply to the grandfather rule in Notice 88-98 apply under the conference agreement.

In addition, the conference agreement provides that section 457 does not apply to nonelective deferred compensation provided to individuals other than in their capacity as employees. For purposes of this rule, a deferred compensation plan is considered nonelective only if all individuals (other than those who have not satisfied any applicable initial service requirement) with the same relationship to the payor are covered under the same plan with no individual variations or options. For example, if a nonemployee doctor receives deferred compensation from a hospital, such deferred compensation is to be considered nonelective only if all nonemployee doctors (who have satisfied any applicable initial service requirements) are covered under the same plan. This provision is effective with respect to taxable years beginning after December 31, 1987.

The conference agreement also provides that section 457 does not apply in the case of a plan maintained by a church (as defined for employment tax purposes in sec. 3121(w)(3)(A)), including a qualified church-controlled organization (as defined in sec. 3121(w)(3)(B)). This provision is effective with respect to taxable years beginning after December 31, 1987.

3. Section 403(b) nondiscrimination rules and certain other pension requirements

Present Law

Under present law (as amended by the 1986 Act), nondiscrimination rules apply to contributions to tax-sheltered annuity programs (sec. 403(b)). With respect to contributions pursuant to a salary reduction agreement, the nondiscrimination rules generally require that the ability to make salary reduction contributions be available to all employees. With respect to other contributions, the nondiscrimination rules are the same nondiscrimination rules applicable to qualified pension plans.

House Bill

The House bill provides that, in the absence of rules on which employers may rely, employers are permitted to make good faith reasonable interpretations of the section 403(b) nondiscrimination requirements. This reasonable interpretation standard remains in effect until the later of the first plan year beginning after December 31, 1990, or at least six months following the issuance of rules on which a taxpayer may rely.

The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment modifies the nondiscrimination rules applicable to contributions to tax-sheltered annuity programs not made pursuant to a salary reduction agreement as follows: (1) student employees who are not taken into account for employment tax purposes may be disregarded, (2) employees who normally work less than 20 hours per week may be disregarded, and (3) for plan years beginning before January 1, 1992, the nondiscrimination rules may be applied by testing a statistically valid sample of employees. The legislative history of the Senate amendment provides that the nondiscrimination tests may be applied by testing at the level of the institution that maintains the plan and that the special rules applicable to multiple employer qualified plans (sec. 413(c)) apply to multiple employer tax-sheltered annuity programs.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with the clarification that the provision is effective as if included in section 1120(b) of the Reform Act. The conferees intend that the institution maintaining the plan is generally to be interpreted as not including any employer (or portion thereof) that may not maintain a section 403(b) annuity program.

4. Required beginning date for public employees

Present Law

Under the Reform Act, benefits under qualified plans, IRAs, sec. 457 plans, and tax-sheltered annuities are required to begin no later than the April 1 of the calendar year following the calendar year in which the participant or owner attains age 70½. This rule is generally effective for years beginning after December 31, 1988. Prior to the Reform Act, distributions from such plans were generally required to begin by the later of (1) the April 1 of the calendar year following the calendar year in which the participant or owner attained age 70½, or (2) the calendar year in which the participant retired.

House Bill

The House bill repeals the Reform Act required beginning date with respect to governmental plans. Thus, under the House bill, the pre-Reform Act required beginning date rule applies to such plans.

The House bill provision is effective as if included in the Reform Act.

Senate Amendment

The Senate amendment delays the general effective date of the Reform Act rule for 1 year for governmental plans and plans maintained by employers described in section 501(c)(3).

The Senate amendment provision is effective as if included in the Reform Act.

Conference Agreement

The conference agreement follows the House bill, except that the provision also applies to church employees. For this purpose, the term "church" has the meaning given such term by section 3121(w)(3)(A), including a qualified church controlled organization (as defined in section 3121(w)(3)(B)).

5. Limitations on contributions and benefits under qualified plans maintained by public employers

Present Law

Present law provides overall limits on contributions and benefits under qualified plans (sec. 415). The limits apply to all such contributions and benefits provided to an individual by any private or public employer. The overall limits have been modified several times beginning with the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

House Bill

Under the House bill, in the case of a plan maintained by any State or local government, the limitation on benefits under a defined benefit pension plan with respect to a qualified participant is the greater of (1) the limitation normally applicable to benefits under a defined benefit pension plan, or (2) the accrued benefit of the participant without regard to any benefit increases pursuant to a plan amendment adopted after October 14, 1987. A qualified participant is a participant who first became a participant in the plan before January 1, 1989.

The special rule does not apply unless the employer elects, by the close of the first plan year beginning after December 31, 1988, to have the normal section 415 limits (other than the special limits applicable to qualified police and firefighters) apply to all plan participants other than qualified participants.

In the case of an employer electing to apply the House bill provision, the provision generally applies to years beginning after December 31, 1982, and the normal section 415 limits apply to years beginning on or after January 1, 1989.

Senate Amendment

The Senate amendment is the same as the House bill, except that a qualified participant is a participant who first became a participant before January 1, 1990, rather than January 1, 1989, and the election for general application of the 415 limits is required to be made by the close of the first plan year beginning after December 31, 1989, rather than December 31, 1988.

The effective date is the same as the House bill, except that the normal section 415 limits apply with respect to plans of an electing employer to years beginning on or after January 1, 1990.

Conference Agreement

The conference agreement follows the Senate amendment.

6. Minimum participation rule

Present Law

Under present law, a plan is not a qualified plan unless it benefits no fewer than the lesser of (1) 50 employees of the employer, or (2) 40 percent of all employees of the employer (sec. 401(a)(26)).

House Bill

The House bill provides that the minimum participation rule does not apply to any governmental plan with respect to employees who were participants in the plan on July 14, 1988.

The House bill provision is effective on date of enactment.

Senate Amendment

The Senate amendment provides that the minimum participation rule may be applied separately to qualified public safety employees of a governmental employer for whom a separate plan is maintained and other employees of the employer. Qualified public safety employees are employees of a public employer who provide police, firefighting, or emergency medical services.

The Senate amendment also requires the Treasury Department to conduct a study on application of the minimum participation rule to certain government contractors that are required by Federal law to provide certain employees with specific retirement benefits.

The Senate amendment provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the application of the minimum participation rule to qualified safety employees, with a clarification that the provision is effective as if included in section 1112(b) of the Reform Act, and the Treasury study.

The conference agreement follows the House bill with respect to governmental plans, with the modification that the provision only applies to plan years beginning before January 1, 1993. The provision is effective as if included in section 1112(b) of the Reform Act.

7. Permit IRA acquisitions of State-issued coins

Present Law

The acquisition by an individual retirement arrangement (IRA) of any collectible is treated as a distribution from the IRA equal to the cost of the collectible and is includible in the IRA owner's income for the year in which the cost is deemed distributed (sec. 408(m)). Under the Reform Act, certain gold and silver coins issued by the United States Government are not treated as collectibles.

House Bill

No provision.

Senate Amendment

Coins issued under the laws of any State are not treated as collectibles for purposes of the IRA prohibition on investments in collectibles, as long as the coins are held by a person independent of the IRA owner.

The provision is effective with respect to State coins acquired by an IRA after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

8. Application of pension funding rules to multiple employer plans

Present Law

Under present law, the minimum funding requirement with respect to a multiple employer plan and the maximum permissible deductible contribution to a multiple employer plan are calculated at the plan level and not on a contributing employer by contributing employer basis (sec. 413(c)).

House Bill

No provision.

Senate Amendment

Under the Senate amendment, in the case of a plan established after December 31, 1988, each employer participating in a multiple employer pension plan is treated as maintaining a separate plan for purposes of the minimum funding standard unless the plan uses a method for determining required contributions that ensures that any employer contributes an amount at least equal to the amount that would be required if the employer maintained a separate plan.

The provision is effective on the date of enactment with respect to plans established after December 31, 1988. In the case of a multiple employer plan established on or before December 31, 1988, the plan administrator is permitted to elect to have the new rule apply to the plan. The election is required to be made on or before the last day of the first plan year beginning after the date of enactment and applies to the plan year during which the election is made and all subsequent plan years and may be revoked only with the consent of the Secretary.

Conference Agreement

The conference agreement follows the Senate amendment.

As under the Senate amendment, the minimum funding standard is to be determined by treating each employer in a multiple employer plan as maintaining a separate plan, unless the plan's method for determining required contributions assures that each employer will contribute at least the amount that would be required if each employer were maintaining a separate plan. If the plan's method satisfies this requirement, then the multiple employer plan will file only a single Form 5500 and only a single Schedule B for the entire plan will be required to be prepared. Plans are required, however, to be able to demonstrate compliance with the employer-by-employer rule. It may be possible to demonstrate this compliance, for example, by using appropriate plan-wide assumptions for turnover, mortality, future growth in wages, and investment experience such that each employer contributed, at a minimum, the sum of normal cost plus required amortization of any unfunded liabilities, or net experience or other losses reduced by the amortization of any credits for experience or other gains and any contributions the deduction for which would be denied by the full funding limitation. Each employer's normal cost is required to reflect the actual salary and demographics of its employees. In addition, unfunded past service liabilities are to be amortized at least as rapidly as required by the minimum funding rules applicable to qualified plans. Under any acceptable method, no deficiencies arise and no prior year credit balances are permitted with respect to any employer.

Under the conference agreement, the assets and liabilities of each plan treated as a separate plan are the assets and liabilities that would be allocated to a plan maintained by the employer if the employer withdrew from the multiple employer plan, determined under a reasonable and consistent method. It is intended that the Secretary prescribe rules to prevent plan withdrawal mechanisms from being manipulated in order to avoid the deduction limits.

9. Application of section 415 limits to police and firefighters

Present Law

Present law (sec. 415) provides overall limits on contributions and benefits under qualified pension, profit-sharing, and stock bonus plans, qualified annuity plans, tax-sheltered annuities, and simplified employee pensions (SEPs). In addition, present law provides a special floor on the annual limit on benefits with respect to certain police and firefighters. In the case of a qualified participant, the present-law reduction provided for benefits payable before age 62 does not reduce the dollar limit on annual benefits below $50,000 at any age.

A qualified participant is a participant in a defined benefit pension plan maintained by a State or political subdivision of a State if the period of service taken into account in determining the participant's benefit under the plan includes at least 20 years of the participant's service as (1) a full-time employee of any police department or fire department that is organized and operated by the State or political subdivision of a State maintaining the plan to provide police protection, firefighting services, or emergency medical services for any area within the jurisdiction of that State or subdivision, or (2) a member of the Armed Forces of the United States.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the 20 years of service requirement for eligibility for the special rule for police and firefighters is decreased to 15 years.

The provision is effective as if included in the Tax Reform Act of 1986.

Conference Agreement

The conference agreement follows the Senate amendment.

10. Employee leasing safe harbor

Present Law

Certain employees of a leasing organization are considered employees of the service recipient for purposes of certain pension and employee benefit rules (sec. 414(n)). Under a safe-harbor rule, a service recipient is not required to maintain records with respect to leased employees if, among other things, less than 5 percent of the recipient's workforce are leased employees (determined in a simplified manner).

House Bill

No provision.

Senate Amendment

Under the Senate amendment, certain individuals are not considered leased employees of a service recipient if the service recipient satisfies the 5-percent test if the percentage is raised to 10 percent. The exempted individuals include any individual who (1) is credited with less than 3,000 hours of service for the service recipient over any two consecutive plan years, and (2) did not perform services (as an employee or otherwise) for the service recipient within the same geographic area at any time within the plan year immediately preceding the two-plan-year period.

The provision is effective on the date of enactment with respect to services performed after December 31, 1986.

Conference Agreement

The conference agreement follows the House bill.

11. Air transportation of cargo and passengers treated as same service for purposes of fringe benefit inclusion

Present Law

Under present law, a no-additional-cost service provided to an employee is not included in the employee's gross income (sec. 132). In order to qualify as a no-additional-cost service, a service is required to be offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services.

House Bill

The House bill provides that the transportation of cargo by air and the transportation of passengers by air is treated as the same service for purposes of the exclusion for no-additional-cost services.

The House bill provision applies to transportation furnished after December 31, 1987, in taxable years ending after such date.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

12. Excise tax on dispositions of stock by an ESOP not to apply to certain involuntary dispositions

Present Law

Under present law, if an employee stock ownership plan (ESOP) acquires stock pursuant to a sale that qualifies for a special estate tax deduction for sales of stock to an ESOP (sec. 2057), an excise tax applies if the ESOP disposes of the stock within 3 years of the acquisition. The excise tax applies to all dispositions, whether voluntary or involuntary, except for dispositions specifically excepted from the rule.

House Bill

The House bill provides that the excise tax applicable in the case of certain dispositions of stock acquired in a section 2057 transaction does not apply to forced dispositions occurring by operation of a State law.

The House bill provision is effective as if included in the Revenue Act of 1987.

Senate Amendment

The Senate amendment is the same as the House bill, except that the exception only applies to forced dispositions of employer securities that are readily traded on an established securities market at the time of the disposition of the securities by the ESOP.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that the exception applies if the securities are readily traded on an established securities market at the time the securities were acquired by the ESOP.

13. Exclusion of interest paid on refinanced ESOP loans

Present Law

Under present law, a bank, an insurance company, a regulated investment company, or a corporation actively engaged in the business of lending money may exclude from gross income 50 percent of the interest received with respect to a securities acquisition loan (sec. 133). A "securities acquisition loan" is generally defined as a loan to a corporation or to an ESOP to the extent that the proceeds are used to acquire employer securities.

House Bill

No provision.

Senate Amendment

The Senate amendment modifies a provision in technical corrections by providing that, in the case of a refinancing of a securities acquisition loan that was made before October 22, 1986, the partial interest exclusion under section 133 is available for the greater of (1) the term of the original securities acquisition loan, or (2) the amortization period used to determine the regular payments under the original securities acquisition loan.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

14. Nondiscrimination rules for cafeteria plans

Present Law

Under present law, a cafeteria plan must be available to a reasonable classification of employees that does not discriminate in favor of highly compensated employees (sec. 125). An employer may test coverage of its employee benefit plans (other than cafeteria plans) separately on a line of business basis under certain circumstances. In order to test a plan on this basis, the plan must cover a reasonable classification of employees that does not discriminate in favor of highly compensated employees.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the Secretary may (but is not required to) provide that the reasonable classification test applicable to cafeteria plans (sec. 125(b)(1)) is applied in a different manner than the reasonable classification test applicable under the qualified plan coverage (sec. 410(b)) and line of business rules (sec. 414(r)).

The provision is effective as if included in section 1151(d)(1) of the Reform Act.

Conference Agreement

The conference agreement follows the House bill.

15. Cash or deferred arrangements of railroad employees

Present Law

Under present law, a qualified plan is required to satisfy coverage rules designed to ensure that rank-and-file employees, as well as highly compensated employees are covered by the plan. These rules require, in general, that a certain percentage of the nonhighly compensated employees of the employer be covered by the plan (sec. 410(b)). In determining whether a plan satisfies the coverage rules, employees subject to a collective bargaining agreement who are not covered by the plan are disregarded. However, in applying the coverage rules to a plan established pursuant to a collective bargaining agreement, all employees of the employer are taken into account.

A special exception to the general rules for employees subject to a collective bargaining agreement permits the coverage rules to be applied to a plan established pursuant to a collective bargaining agreement covering air pilots as if the employees covered by the bargaining agreement were the only employees of the employer.

A qualified cash or deferred arrangement (sec. 401(k)) is required to benefit a group of employees that satisfies the coverage rules.

House Bill

No provision.

Senate Amendment

The Senate amendment expands the special rule for collectively bargained plans covering air pilots to collectively bargained plans for railroad employees.

The provision is effective for years beginning after December 31, 1988.

Conference Agreement

The conference agreement follows the House bill.

16. Application of section 415 limits to collectively bargained plans

Present Law

Under present law, the limit on the annual benefit provided by a defined benefit pension plan is generally the lesser of (1) 100 percent of average compensation, or (2) $90,000 (sec. 415). Prior to the Reform Act, if payment of retirement benefits began before age 62, then the dollar limit was generally reduced so that it was the actuarial equivalent of an annual benefit of $90,000 beginning at age 62. In no event, however, was the dollar limit applicable to benefits beginning at or after age 55 less than $75,000.

Under the law prior to the Reform Act, if benefits began before age 55, then the dollar limit was actuarially reduced so that it was the greater of (1) the actuarial equivalent of a $75,000 benefit beginning at age 55, or (2) the actuarial equivalent of the applicable dollar limit at age 62.

The Reform Act eliminated the $75,000 floor so that the $90,000 limit is actuarially reduced for a participant retiring before the social security retirement age (currently 65, scheduled to increase to 67).

In the case of a plan maintained pursuant to one or more collective bargaining agreements ratified before March 1, 1986, the Reform Act provisions do not apply to benefits under such agreements in years beginning before the earlier of (1) the date on which the last of such collective bargaining agreements terminates, or (2) January 1, 1989.

House Bill

No provision.

Senate Amendment

The Senate amendment further extends the effective date of the Reform Act provisions in the case of collectively bargained plans. Under the amendment, in the case of a plan established on or before March 1, 1986, pursuant to one or more collective bargaining agreements, the Reform Act provisions do not apply to benefits pursuant to such agreements until the first plan year beginning on or after October 1, 1991.

Conference Agreement

The conference agreement follows the Senate amendment.

17. Application of section 89 nondiscrimination rules to small employers

Present Law

Under present law, a health and certain other employee benefit plans are required to satisfy certain nondiscrimination rules (sec. 89). Such a plan is considered nondiscriminatory if it satisfies three eligibility tests and a benefits tests. Under an alternative test, a plan is considered nondiscriminatory if it benefits at least 80 percent of the employer's nonhighly compensated employees.

Under present law, employees who normally work less than 17 1/2 hours per week are disregarded for purposes of the nondiscrimination rules.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, in applying the 80-percent test to a plan maintained by an employer with less than 10 employees (1) employees who normally work 35 hours or less per week may be disregarded in applying the test to plan years beginning in 1989, (2) employees who normally work 25 hours may be disregarded in applying the test to plan years beginning in 1990, and (3) the present-law rule applies to plan years beginning in or after 1991.

The provision is effective as if included in the 1986 Act.

Conference Agreement

The conference agreement follows the Senate amendment.

18. Allocation of assets in case of plan spin offs

Present Law

Under present law, a plan is not a qualified plan unless in the case of any merger or consolidation of the plan with, or in the case of any transfer of assets or liabilities of such plan to, any other plan, each participant receives benefits on a termination basis from the plan immediately after the merger, consolidation, or transfer that is at least equal to the benefit the participant would have received on a termination basis immediately before the merger, consolidation, or transfer (sec. 414(l)). This rule also applies to plan spin offs, that is, the splitting of a plan into two or more plans.

House Bill

No provision.

Senate Amendment

The technical corrections provisions of the Senate amendment (sec. 205(c) of the Senate amendment) provide that, in the case of spin offs and similar transactions involving defined benefit plans (within a controlled group) the excess assets (i.e., assets in excess of the amount required to be allocated to a plan under present law) are to be allocated proportionately among the spun-off plans.

The Senate amendment also provides that the allocation rule applies to a spin off involving a plan maintained by a bank that has been closed by appropriate bank authorities and a plan maintained by a bridge bank (as described in 12 U.S.C. 1821(i)). The amendment also authorizes the bridge bank to cause the plan maintained by the closing bank to spin off assets to a defined benefit plan maintained by the bridge bank in accordance with the allocation rule within 180 days after the closing of the bank.

The provision is effective with respect to transactions occurring after July 26, 1988.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the provision relating to bridge banks, with the modification that the provision only applies with respect to 50 percent of the excess assets. (The conference agreement follows the Senate amendment with respect to the technical corrections provision.)

19. Section 401(k) plans available to employees of rural telephone cooperatives

Present Law

Under present law, State and local governments and other tax-exempt organizations (other than rural electric cooperatives) may not maintain section 401(k) plans. The rule prohibiting tax-exempt organizations from maintaining section 401(k) plans generally does not apply to a plan adopted by an organization before July 2, 1986.

House Bill

Under the House bill, rural telephone cooperatives are permitted to maintain section 401(k) plans on the same basis as rural electric cooperatives.

The provision is effective for years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

20. Study of treatment of certain technical services personnel

Present Law

In general, the determination of whether an employer-employee relationship exists for Federal tax purposes is made under a common law test. Under this test, an employer-employee relationship generally exists if the person contracting for services has the right to control not only the result of the services, but also the means by which that result is accomplished.

Section 530 of the Revenue Act of 1978 generally allows a taxpayer to treat a worker as not being an employee, regardless of the individual's actual status under the common law test, unless the taxpayer has no reasonable basis for such treatment. Although section 530 provides relief only with respect to the employment tax liability of the service recipient, it has been widely used to justify claims of independent contractor status for income tax purposes, both by the service recipients and by individuals with respect to whom a service recipient claims relief under section 530.

Section 1706 of the Reform Act provides that section 530 of the Revenue Act of 1978 does not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

House Bill

The House bill directs the Treasury Department to conduct a study of section 1706 and report to the House Ways and Means Committee and the Senate Finance Committee by September 1, 1989. The study is to include evaluation of the following issues: (a) the difficulty of administration of the provisions of section 1706, (b) whether there are any abuses in the reporting of income by independent contractors that justify the adoption of section 1706 (including any evidence of greater noncompliance by independent contractors when compared to employees), (c) the chilling effect that section 1706 has had on the ability of technical services personnel to get work, (d) the administrability of the present-law standards for determining whether an individual is an employee or an independent contractor, and (e) the equity of providing rules that distinguish between independent contractors who work through brokers and those who do not.

The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

21. Taxation of pension distributions to former spouses

Present Law

Under present law, qualified plan benefits of a participant in a qualified plan may be paid to an alternate payee pursuant to a qualified domestic relations order (QDRO). An alternate payee includes a spouse, former spouse, child or other dependent of a participant.

A lump-sum distribution from a qualified plan may, in certain circumstances, qualify for special income averaging. In determining whether a distribution meets the requirement for lump sum treatment that the distribution consist of the balance to the credit of the employee, amounts payable to an alternate payee are not taken into account.

Under present law, lump sum treatment is not available to alternate payees.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement makes income averaging available with respect to distributions to an alternate payee who is a spouse or former spouse of the employee. In particular, the conference agreement provides that if a distribution of the balance of the credit to the employee would constitute a lump-sum distribution, then a distribution of the balance of the credit to the alternate payee constitutes a lump-sum distribution. In determining whether the distribution consists of the balance to the credit of the alternate payee, only the interest of the alternate payee is taken into account.

The provision is effective for taxable years ending after December 31, 1984.

D. Insurance Provisions

1. Church self-insured death benefit plans treated as life insurance

Present Law

Definition of a life insurance contract

Under present law, a life insurance contract is defined as any contract which is a life insurance contract under the applicable law, but only if the contract meets either of two alternative tests: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement.

If a contract does not satisfy the definition of a life insurance contract, the income on the contract for any taxable year of the policyholder will be treated as ordinary income received or accrued by the policyholder during that year.

Exclusion for death benefits

Present law generally excludes from a beneficiary's gross income proceeds of death benefits received under a life insurance contract and provides a limited exclusion for other benefits paid by or on behalf of an employer by reason of an employee's death.

Exclusion for group-term life insurance

Under present law, the cost of group-term life insurance purchased by an employer for an employee for a taxable year is included in the employee's gross income to the extent that the cost is greater than the sum of the cost of $50,000 of life insurance plus any contribution made by an employee to the cost of the insurance.

House Bill

Under the House bill, the term "life insurance contract" generally includes certain church self-funded death benefit arrangements, even if the arrangements do not constitute life insurance under applicable State law. Thus, the death benefit exclusion and the exclusion for the cost of employer-provided group-term life insurance apply to a plan or arrangement that provides for the payment of benefits by reason of the death of an individual covered under such a self-funded plan or arrangement, but only if the plan or arrangement (1) is provided directly by a church for the benefit of its employees and their beneficiaries, by a church plan, or by a church-controlled organization; and (2) satisfies the requirements relating to the definition of a life insurance contract other than the requirement that the plan or arrangement be a life insurance contract under the applicable law.

The provision is effective as if included in the Deficit Reduction Act of 1984 (i.e., generally, for contracts issued after December 31, 1984).

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Minimum tax treatment of structured settlement arrangements

Present Law

For regular income tax purposes, the income on an annuity contract held by a corporation or other nonnatural person is included in income (sec. 72(u)(2)). An exception to this rule of inclusion is provided in the case of income on an annuity contract that is a qualified funding asset under a structured settlement arrangement (sec. 72(u)(3)(C)), without regard to whether there is a qualified assignment.

The adjusted current earnings provision of the corporate alternative minimum tax (sec. 56(g)) requires the inclusion of the income on any annuity contract (as determined under sec. 72(u)(2), which defines income on the contract). The adjusted current earnings provision does not incorporate the section 72(u)(3)(C) exception in the case of annuity contracts that are qualified funding assets.

House Bill

The House bill provides an exclusion from the adjusted current earnings of a corporation under the alternative minimum tax, in the case of income on an annuity contract that is a qualified funding asset within the meaning of section 130(d) (without regard to whether there is a qualified assignment). Similarly, the bill provides that income on annuity contracts held under a plan described in section 403(a) is excluded from the calculation of the adjusted current earnings preference.

The provision is effective for taxable years beginning after December 31, 1989 (i.e., the effective date for the adjusted current earnings provision).

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Repeal of general creditor requirement for certain personal injury liability assignments

Present Law

Under present law, an exclusion from gross income is provided for amounts received for agreeing to a qualified assignment to the extent that the amount received does not exceed the aggregate cost of any qualified funding asset.

A qualified assignment means any assignment of a liability to make periodic payments as damages on account of a personal injury or sickness (in a case involving physical injury or physical sickness), provided the terms of the assignment satisfy certain requirements. Generally, these requirements are that (1) the periodic payments are fixed as to amount and time; (2) the payments cannot be accelerated, deferred, increased, or decreased by the recipient; (3) the assignee's obligation is no greater than that of the person assigning the liability; (4) the payments are excludable to the recipient as damages; and (5) the assignee does not provide to the recipient of such payments rights against the assignee that are greater than those of a general creditor.

House Bill

Under the House bill, a liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor. The bill also provides that no amount is currently includible in the recipient's income solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor.

The provision applies to liability assignments made after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Treatment of certain workers' compensation funds

Present Law

Under applicable State law or regulation, workers' compensation liabilities may be pooled as self-insured workers' compensation funds. Such funds generally are treated as mutual property and casualty insurance companies for Federal income tax purposes. In audits, the Internal Revenue Service has raised the issue whether the requirements for deductibility of policyholder dividends have been met in cases in which the declared dividend is contingent upon subsequent approval of the amount of the dividend by State regulatory authorities (e.g., the State workers' compensation board). The Tax Reform Act of 1986 imposed a moratorium with respect to audits and litigation relating to self-insured workers' compensation funds for the period commencing on October 22, 1986, and ending on August 16, 1987.

House Bill

Under the House bill, for taxable years beginning before January 1, 1987, a deficiency is not to be assessed against (and, if assessed, is not to be collected from) a qualified group self-insurers' fund to the extent that the deficiency is attributable to the timing of the deduction for policyholder dividends. For taxable years beginning on or after January 1, 1987, a fund's deduction for policyholder dividends is allowed no earlier than the date that the State regulatory authority determines the amount of the policyholder dividend that may be paid.

The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with modifications.

The conference agreement modifies the House bill definition of a "qualified group self-insurers' fund" to provide that it is defined as a group of two or more employers that has been in existence for at least two years, and who enter into agreements to pool their liabilities under State workers' disability compensation laws.

The conference agreement also modifies the statutory requirements that the group is required to meet. The conference agreement deletes the requirement that the group be bound by State law or regulation or by its governing documents to promptly return to its members all monies not needed to pay, or reserve against, claims under the State workers' disability compensation laws and expenses.

The conference agreement also provides that a group is a qualified group self-insurers' fund only if the group is required by State law or regulation to submit an audited financial statement to the State regulatory authority. The conference agreement adds other investments which are approved by the State board or agency that is responsible for administering the State workers' disability compensation laws to the list of specifically permitted investments.

Finally, the conference agreement adds a requirement that the group exclusively covers workers' compensation liability, is not a commercial insurance carrier or company licensed by the State board, agency or commissioner responsible for regulating and licensing insurance carriers and companies, and is not subject to a requirement to file with insurance regulatory authorities statements approved by the National Association of Insurance Commissioners.

5. Prepaid tax certificates

Present Law

Property and casualty insurance companies are required to discount unpaid loss reserves to take account partially of the time value of money. Thus, the deduction for unpaid losses is limited to the net increase in the amount of discounted unpaid losses. Any net decrease in loss reserves results in income inclusion, but the amount to be included is computed on a discounted basis.

House Bill

Any insurance company that is required to discount unpaid losses is allowed an additional deduction that is not to exceed the excess of (1) the amount of the undiscounted unpaid losses over (2) the amount of the related discounted unpaid losses, to the extent the amount was not deducted in a preceding taxable year. This deduction is available only if the company purchases a prepaid tax certificate in an amount equal to the tax benefit attributable to the deduction. The company is required to establish a special loss discount account to which is added each year the amount of the additional deduction under this provision. The prepaid tax certificate is to be redeemed only when the amount of the above deduction is released from the company's special loss discount account and included in income. The amount redeemed may be applied only to pay taxes due because of this inclusion.

The provision is effective for taxable years beginning after December 31, 1987.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill with modifications.

In general

In general, the conference agreement follows the provision of the House bill allowing an additional deduction that is not to exceed the excess of (1) the amount of the undiscounted unpaid losses over (2) the amount of the related discounted unpaid losses, to the extent the amount was not deducted in a preceding taxable year. The conference agreement also generally follows the House bill requirement that a special loss discount account be established and maintained. The provision of the House bill requiring the purchase of prepaid tax certificates is modified to substitute a requirement for "special estimated tax" payments. The House bill is further modified to add a rule treating certain unused amounts of special estimated tax payments as a section 6655 estimated tax payment for the 16th year after the year for which the special estimated tax payment was made. The conference agreement provides additional Treasury regulatory authority.

The total payments by a taxpayer, including section 6655 estimated tax payments and other tax payments, together with special estimated tax payments made under this provision, are generally the same as the total tax payments that the taxpayer would make if the taxpayer did not elect to have this provision apply (except to the extent amounts can be refunded under the provision in the 16th year).

Special estimated tax payments

The requirement of the House bill that the taxpayer purchase prepaid tax certificates is eliminated. The conference agreement imposes a requirement that the taxpayer make special estimated tax payments in an amount equal to the tax benefit attributable to the additional deduction allowed under the provision. If amounts are included in gross income due to a reduction in the taxpayer's special loss discount account or due to the liquidation or termination of the taxpayer's insurance business, and an additional tax is due for any year as a result of the inclusion, then an amount of the special estimated tax payments equal to such additional tax is applied against such additional tax. If there is an adjustment reducing the amount of additional tax against which the special estimated tax payment was applied, then in lieu of any credit or refund for the reduction, a special estimated tax payment is treated as made in an amount equal to the amount that would otherwise be allowable as a credit or refund.

The amount of the tax benefit attributable to the deduction is to be determined, under Treasury regulations, by taking into account tax benefits that would arise from the carryback of any net operating loss for the year as well as current year benefits. In addition, tax benefits for the current and carryback years are to take into account the benefit of filing a consolidated return with another insurance company without regard to the consolidation limitations imposed by section 1503(c).

The taxpayer's estimated tax payments under section 6655 are to be determined without regard to the additional deduction allowed under this provision and the special estimated tax payments. It is intended that the taxpayer may apply the amount of an overpayment of his section 6655 estimated tax payments for the taxable year against the amount of the special estimated tax payment required under this provision. The special estimated tax payments under this provision are not treated as estimated tax payments for purposes of section 6655 (e.g., for purposes of calculating penalties or interest on underpayments of estimated tax) when such special estimated tax payments are made.

Refundable amount

The conference agreement provides that, to the extent that a special estimated tax payment is not used to offset additional tax due for any of the first 15 taxable years beginning after the year for which the payment was made, such special estimated tax payment is treated as an estimated tax payment made under section 6655 for the 16th year after the year for which the special estimated tax payment was made. If the amount of such deemed section 6655 payment, together with the taxpayer's other payments credited against tax liability for such 16th year, exceeds the tax liability for such year, then the excess (up to the amount of the deemed section 6655 payment) may be refunded to the taxpayer to the same extent provided under present law with respect to overpayments of tax.

Regulatory authority

In addition to the regulatory authority provided under the House bill to adjust the amount of special estimated tax payments in the event of a change in the corporate tax rate, the conference agreement provides authority to the Treasury Department to prescribe regulations necessary or appropriate to carry out the purposes of the provision.

Such regulations include those providing for the separate application of the provision with respect to each accident year. Separate application of the provision with respect to each accident year (i.e., applying a vintaging methodology) may be appropriate under regulations to determine the amount of tax liability for any taxable year against which special estimated tax payments are applied, and to determine the amount (if any) of special estimated tax payments remaining after the 15th year which may be available to be refunded to the taxpayer.

Regulatory authority is also provided to make such adjustments in the application of the provision as may be necessary to take into account the corporate alternative minimum tax. Under this regulatory authority, rules similar to those applicable in the case of a change in the corporate tax rate are intended to apply to determine the amount of special estimated tax payments that may be applied against tax calculated at the corporate alternative minimum tax rate. The special estimated tax payments are not treated as payments of regular tax for purposes of determining the taxpayer's alternative minimum tax liability.

6. Phase-in of property and casualty insurance company discounting rules for certain hospital insurers

Present Law

Present law limits the reserve for unpaid losses of property and casualty insurance companies to the amount of discounted unpaid losses. The amount of discounted unpaid losses is determined on a line-of-business basis by applying a historical loss payment pattern for the line of business and a specified rate of interest. The discounting rules are effective for taxable years beginning after December 31, 1986, with a fresh start transition rule.

House Bill

No provision.

Senate Amendment

The Senate amendment provides an elective phase in of the discounting rules for taxable years beginning in 1987 and 1988 for qualified nonprofit hospital insurers. A qualified nonprofit hospital insurer is any domestic insurance company other than a life insurance company if, for the taxable year for which an election is in effect, (1) at least 75 percent of the value and voting power of the company is owned by nonprofit health care facilities or trade associations of such facilities; (2) a majority of the insurance or reinsurance provided by the company covers risks of nonprofit health care facilities; and (3) at least 75 percent of the insurance provided by the company is medical malpractice or general liability insurance. Under the phase in, the amount of the discounted unpaid losses of an electing company is to be increased by 20 percent of the difference between discounted and undiscounted unpaid losses for a taxable year beginning in 1987. For a taxable year beginning in 1988, the amount of the discounted unpaid losses of an electing company is to be increased by 10 percent of such difference. The fresh start and reserve strengthening provisions contained in the Tax Reform Act of 1986 apply for each taxable year of an electing company beginning in 1987, 1988, and 1989.

The provision is effective for taxable years beginning in 1987 and 1988.

Conference Agreement

The conference agreement follows the House bill.

7. Diversification requirements for variable annuity and life insurance contracts

Present Law

Under present law, the owner of a variable annuity or variable life insurance contract that is based on a segregated asset account is subject to current taxation on the earnings of the contract if the underlying investments of the segregated asset account are not, under Treasury regulations, adequately diversified (section 817(h)). Treasury regulations provide that any obligation issued, guaranteed or insured by the United States or an agency or instrumentality of the United States is treated as a single investment for purposes of the diversification requirement.

House bill

No provision.

Senate Amendment

Under the Senate amendment, each agency or instrumentality of the United States is treated as a separate issuer for purposes of the diversification requirement.

The provision is effective for taxable years beginning after December 31, 1987.

Conference Agreement

The conference agreement follows the Senate amendment.

E. Excise Tax Provisions

1. Certain tolerances permitted in determination of wine excise tax

Present Law

An excise tax ranging from $0.17 cents per wine gallon (14 percent or less alcohol) to $3.40 per wine gallon (champagne) is imposed on wine. The applicable rate depends on the alcohol content.

House Bill

The Secretary of the Treasury is authorized to prescribe *de minimis* tolerances for the amount of wine contained in commercial containers. If the amount of wine in a container is within these tolerances, tax will not be collected for any excess wine actually in the container. (This same rule applies currently to the excise tax on beer.)

The provision is effective on January 1, 1989.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Gasoline wholesalers permitted to claim refunds on behalf of certain exempt users

Present Law

The gasoline excise tax is imposed on removal of gasoline blend stocks from the refinery or a bonded pipeline terminal. Exemptions for tax are provided for fuels that are exported, sold for use as supplies for vessels or aircraft, sold for use by States and local governments, and sold for use by certain educational organizations.

These exemptions generally are realized by means of refunds (or credits against other taxes) to the ultimate purchasers; however, present law permits refiners and terminal operators (as taxpayers) to claim the refunds on behalf of the cited persons when the taxpayers prove they pass the benefit of the tax exemption through to the ultimate exempt purchaser.

House Bill

Wholesale distributers (defined as under the present-law diesel fuel excise tax provisions) are permitted to claim refunds of tax for gasoline sold by them for (1) export, (2) use by States and local governments, (3) use in aircraft or vessels, or (4) use by certain nonprofit educational organizations. This provision is limited to cases where the gasoline is purchased tax-paid by a wholesale distributor who sells the fuel directly to one of these ultimate exempt purchasers. Further, in these cases, the wholesale distributor selling the gasoline to the exempt purchaser is the only person who may claim the refund on behalf of the exempt user.

The provision does not change the point at which the gasoline tax is collected or the party who remits that tax.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Exemption from truck excise tax where benefit accrues to the United States

Present Law

The Treasury Department has authority generally to exempt articles from manufacturers' excise taxes (other than the gas guzzler and coal taxes) where it is demonstrated that the benefit of the exemption will accrue to the Federal Government. No such authority is provided for the retail excise tax on heavy trucks and trailers.

House Bill

The retail excise tax on heavy trucks and trailers is added to the category of excise taxes for which the Treasury Department can provide exemptions if the benefit accrues to the Federal Government.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Certain repairs not treated as manufacturing for the retail excise tax on trucks

Present Law

Extensive repairs on a truck or trailer after it has been in use for several years may trigger liability under the 12 percent retail excise tax because the repairs are considered to have resulted in the manufacture of a new vehicle (Code sec. 4051).

Three categories of operations performed on a vehicle may be considered manufacturing under Treasury Department rulings. The first category involves additions or modifications to a chassis or body that change the transportation function of the vehicle. The second category involves fabrication of a usable truck from a wrecked vehicle. The third category pertains to a used vehicle on which repairs or other modifications are so extensive that they extend its useful life.

House Bill

No provision.

Senate Amendment

The Senate amendment clarifies that the criteria—the three tests described above—employed to determine whether manufacture of a new truck has occurred are consistent with the intent of the statute. However, in the case of the third test, i.e., repair or manufacture that extends the useful life of a vehicle, a ratio of 75 percent of the price of a comparable new truck is adopted as a safe harbor for determining when repairs are treated as manufacture. In applying this section, the costs of non-emergency repairs, modifications, or upgrades to a vehicle over any 6-month period are to be aggregated in determining whether the 75 percent test is met.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Reduced gasoline excise tax rate for gasohol blenders

Present Law

Registered gasohol blenders pay a 3.43 cents per gallon excise tax on gasoline at the time of removal or sale of any gasoline purchased for producing gasohol. In these situations, the alcohol used in making the gasohol blend is purchased at the same terminal and at the same time. If the same terminal and same time requirement is not met, the purchaser pays 9.1 cents per gallon and applies for a refund of 6 cents per gallon when the mixture qualifies as a gasohol blend.

The refund reflects the 60 cents per gallon credit on alcohol (i.e., not less than 190 proof ethanol or methanol) used to make a gasohol blend; the alcohol credit is 45 cents per gallon for ethanol or methanol at least 150 proof but less than 190 proof. A gasohol blend must contain at least 10 percent alcohol to qualify for this credit. Generally, the term alcohol does not include alcohol produced from petroleum, natural gas, or coal (including peat).

House Bill

No provision.

Senate Amendment

The reduced excise tax rate would apply whether or not the gasoline and alcohol are purchased at an identical location, so long as the purchases are reasonably contemporaneous, i.e., within a 24-hour period, and the blender and seller comply with applicable registration, reporting and recordkeeping requirements imposed by the Secretary of the Treasury.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with a modification which changes the effective date so that it applies to sales after September 30, 1989.

6. Application of annual distilled spirits occupational tax

a. Exemption for certain educational organizations receiving distilled spirits tax-free for research purposes

Present Law

An annual occupational tax of $250 is imposed on persons dealing in specially denatured distilled spirits, including persons using these distilled spirits for research purposes. (The taxable year for the tax is July 1-June 30.)

House Bill

No provision.

Senate Amendment

Exemption from the occupational tax is provided to government and nonprofit educational organizations that purchase 25 gallons or less of these spirits during a calendar year. The provision is effective on July 1, 1989.

Conference Agreement

The conference agreement follows the Senate amendment.

b. Exemption for certain small plants producing exclusively for fuel uses

Present Law

An annual occupational tax of $1,000 per premise is imposed on each proprietor of a distilled spirits plant. The tax is $500 per year for businesses with gross receipts of less than $500,000 in the preceding taxable year (July 1-June 30).

House Bill

No provision.

Senate Amendment

Exemption from the occupational tax is provided to distilled spirits plants which (1) produce distilled spirits exclusively for fuel use, and (2) produce no more than 10,000 proof gallons per year. The provision is effective on July 1, 1989.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Allow quarterly payment of excise tax on bows and arrows

Present Law

An 11-percent manufacturers' excise tax is imposed on certain bows and arrows. This tax, like most other Federal excise taxes, generally is required to be deposited with regard to semi-monthly periods. Excise tax returns are required to be filed on a quarterly basis. (The manufacturers' excise tax on sport fishing equipment is due and payable on the date for filing the quarterly return.)

House Bill

Under the House bill, persons liable for payment of the excise tax on bows and arrows are to be excused from the semi-monthly excise tax deposit requirements. Thus, the tax would be paid when the regular quarterly excise tax returns are required to be filed.

The provision is effective for taxable events occurring after December 31, 1988.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

8. One-year Extension of Commencement Date of Oil Spill Liability Trust Fund and Excise Tax on Petroleum

Present Law

Omnibus Budget Reconciliation Act of 1986

The 1986 Budget Reconciliation Act established the Oil Spill Liability Trust Fund in the Internal Revenue Code and a tax of 1.3 cents per barrel on crude oil and refined products subject to the Superfund petroleum tax.

The trust fund and tax provisions were to have taken effect on the commencement date. The commencement date was to occur on the first day of the first calendar month beginning more than 30 days after the enactment of a law before September 1, 1987 authorizing an oil spill liability program. Since authorizing legislation was not enacted by September 1, 1987, the Oil Spill Liability Trust Fund and tax provisions of the 1986 Budget Reconciliation Act did not take effect.

Superfund petroleum tax

Superfund taxes of 8.2 cents per barrel for domestic crude oil and 11.7 cents per barrel for imported petroleum products are imposed on the receipt of crude oil at a U.S. refinery, the import of petroleum products and, if the tax has not already been paid, on the use or export of domestically produced oil.

House Bill

The House bill extends the commencement date of the Oil Spill Liability Trust Fund and the 1.3 cents per barrel petroleum tax so that the trust fund and petroleum tax will take effect if qualified legislation authorizing an oil spill liability program is enacted by December 31, 1990.

Senate Bill

No provision.

Conference Agreement

The conference agreement follows the House bill.

9. Harbor maintenance tax

a. Exemption from harbor maintenance tax for cargo donated for humanitarian purposes

Present Law

The Water Resources Development Act of 1986 (P.L. 99-662) established a new harbor maintenance user tax of 0.04 percent of the value of the commercial cargo loaded or unloaded at a United States port (sec. 4461), effective on April 1, 1987. Commercial cargo is defined as any cargo transported on a commercial vessel, including passengers transported for compensation or hire.

Under regulations issued by the U.S. Customs Service, the user tax is assessed on any cargo loaded or unloaded at a U.S. port, unless otherwise exempted. No exception is made in the statute or in the regulations for cargo, usually food, clothing or medical supplies, which is to be donated overseas for humanitarian or developmental reasons.

House Bill

The bill excludes from the harbor maintenance tax cargo that is donated for humanitarian and development assistance overseas, where such cargo is owned or financed by a non-profit organization or cooperative and where the Customs Service certifies that the cargo is, in fact, intended for donation overseas.

The provision is effective on April 1, 1987 (the effective date of the tax).

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The Conference agreement follows the House bill and the Senate amendment. The conferees intend that "overseas" includes foreign contiguous countries, i.e., Canada and Mexico.

b. Harbor maintenance tax to be imposed once on certain Alaska, Hawaii or possessions cargo

Present Law

The Water Resources Development Act of 1986 (P.L. 99-662) established a harbor maintenance user tax of 0.04 percent of the value of the commercial cargo loaded or unloaded at a United States port (sec. 4461), effective on April 1, 1987. Commercial cargo is defined as any cargo transported on a commercial vessel, including passengers transported for compensation of hire.

Under regulations issued by the U.S. Customs Service, the user tax is assessed on any cargo loaded or unloaded at a U.S. port, unless otherwise exempted. Under present law and regulations, multiple taxation may occur on import and export cargo discharged at a U.S. port for waterborne conveyance to another U.S. port on a different vessel.

No tax is imposed on cargo shipped between the U.S. mainland and Alaska, Hawaii, or a U.S. possession for ultimate use therein. Exempt cargo does not include crude oil with respect to Alaska.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the harbor maintenance tax is to be imposed only once on cargo (other than Alaska crude oil) that is loaded or unloaded in a continuous transportation under a single bill of lading to or from a port in Alaska, Hawaii, or a U.S. possession. The provision is intended to be effective on the date of enactment.[1]

Conference Agreement

The conference agreement follows the Senate amendment, effective on the date of enactment.

10. Study of cigarette excise tax and effects of smoking on health care costs; economic impact of tobacco excise taxes

Present Law

Excise taxes are imposed on cigars, cigarettes, cigarette paper and tubes, and on snuff and chewing tobacco. The tax on small cigarettes is 16 cents per pack of 20 cigarettes. Most taxable cigarettes are small cigarettes.

House Bill

The House bill requires an on-going study by the Secretary of the Treasury, after consulting with the Surgeon General, of:

(1) the public and private health care costs incurred (with respect to smokers, their spouses, and others) as a result of cigarette smoking in the United States;

(2) the incidence of cigarette smoking in the U.S. by adults and by teenage and younger children; and

(3) the impact of the rate of the cigarette excise tax on smoking by adults and by teenage and younger children.

Reports of the results of the study are to be submitted every two years to the House Committee on Ways and Means and the Senate Committee on Finance, with the first report to be submitted by January 1, 1989.

Senate Amendment

The Senate amendment requires a study by the Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, of:

(1) the direct public (and private, to the extent determinable) health care costs incurred (with respect to smokers, their spouses, and others) as a result of cigarette smoking in the United States;

(2) the changes in incidence of cigarette smoking in the U.S. over the past 20 years;

(3) the impact of the rate of the cigarette excise tax on cigarette smoking among all age groups;

(4) the distributional effects of all Federal tobacco excise taxes among income classes;

(5) the impact of changes in the cigarette excise tax rate on State and local cigarette tax revenues and on the farm economy; and

(6) the changes in cigarette excise tax rates imposed by States and localities since 1958.

---

[1] See explanation of the amendment, 134 Cong. Rec. S 15413 (October 11, 1988).

The report of the study is to be submitted to the House Committees on Ways and Means and Agriculture and the Senate Committees on Finance and Agriculture. The report is due by July 1, 1989.

Conference Agreement

The conference agreement does not include either the House provision or the Senate amendment.

F. Foreign Provisions

1. Dual resident companies

Present Law

Prior to the Tax Reform Act of 1986, certain U.S. corporations subject to income tax in a foreign country on their income without regard to its source or on a residence basis (so-called "dual resident companies") could consolidate with one set of affiliates in the United States and another set in a foreign country simultaneously. In these cases, a dual resident company with a net loss could use that loss to reduce the taxes on two separate streams of income.

The 1986 Act prevents the double use of losses that prior law allowed. Thus, a loss of a dual resident company may in some cases be used to reduce the taxes on income of other members of its foreign affiliated group, but not of its U.S. affiliated group. Under U.S. and U.K. law, however, there are cases in which the loss of a dual resident company with U.K. residence may not be used to offset the income of any other affiliate, U.S. or foreign. In order to restore the use of its losses in the United Kingdom, such a company must reorganize as a U.K. corporation. However, such a reorganization may be a taxable event if the U.S. parent of the dual resident company has an "excess loss account" with respect to the stock of the dual resident company. An excess loss account is created in the stock of a U.S. corporation when losses derived by, and distributions from, that U.S. corporation are in excess of its parent's basis in its stock.

House Bill

The House bill provides that a U.S. corporation, with respect to whose stock there is an excess loss account which arose prior to January 1, 1988 and while the corporation was a dual resident company, would be allowed to reorganize as a new foreign corporation without triggering the potential tax associated with the excess loss account. Instead, the excess loss account would be suspended until the stock in the new foreign corporation is disposed of outside of the affiliated group. In addition, rules would be provided so that the new foreign corporation's income is subject to full U.S. tax jurisdiction until the excess loss account is reduced to zero or is recaptured.

The House bill is effective for transactions occurring after date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill except for one technical modification. Consistent with the treatment accorded U.S. consolidated corporations, the modification provides that the income derived by the new foreign corporation and which is included in the U.S. parent's income currently increases the foreign corporation's excess loss account when that income is distributed to the U.S. parent.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Election to treat passive foreign investment company (PFIC) stock as stock in a qualified electing fund

Present Law

A taxpayer's gain from the sale of stock in a passive foreign investment company (PFIC) and certain income received from a PFIC generally are treated as if earned over the period the stock was held by the taxpayer. An interest charge is imposed on any deferred taxes: that is, taxes attributable to income that is treated as earned in previous years. Under present law, income and gains with respect to PFIC stock are not subject to deferred tax and interest if the PFIC has elected to be treated as a qualified electing fund and certain other requirements are met.

House Bill

The House bill provides that the election to be subject to the qualified electing fund rules would be made at the U.S. shareholder level, on a shareholder by shareholder basis, rather than at the company level. The shareholder election would be available, however, only where the PFIC complied with appropriate requirements (as prescribed by regulation) to determine the income of the company and other information necessary to carry out the PFIC provisions.

The House bill is effective in taxable years beginning after December 31, 1986.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Debt-equity ratio of Netherlands Antilles finance subsidiaries

Present Law

The Tax Reform Act of 1984, along with the repeal of the U.S. withholding tax on U.S. source interest paid to foreign persons, provided assurance that interest paid on certain debt obligations issued by U.S. corporations to certain controlled foreign corporations, which in turn had issued debt to foreign persons, would not be subject to U.S. withholding tax so long as the controlled foreign corporations met certain requirements. One of those requirements was that the controlled foreign corporation could have a debt-equity ratio of no greater than five-to-one.

House Bill

The House bill provides that a qualified controlled foreign corporation could increase its debt-equity ratio to 25-to-1 and still satisfy the requirements of the 1984 Act.

The House bill is effective in taxable years ending after date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. The conferees do not intend that any inference be drawn from the agreement's expansion of the debt-equity ratio for applicable CFC's (as defined in the 1984 Act) regarding the proper treatment of this issue in other contexts. The conferees do not intend that this relief provision serve as precedent for the U.S. tax treatment of other similar transactions involving tax treaties or domestic tax law.

4. Treatment of certain insurance branches of controlled foreign corporations

Present Law

Subject to exceptions, income earned by a U.S.-controlled foreign corporation is not taxed by the United States until that income is distributed to the U.S. persons owning the stock of the foreign corporation. Under present law, such deferral of current U.S. tax is not available for insurance income derived by U.S.-controlled foreign corporations, except in the case of underwriting income attributable to risks of property or activities in, or the lives or health of residents of, the country in which the controlled foreign corporation is organized.

House Bill

Under the House bill, a qualified insurance branch of a controlled foreign corporation is treated as a separate corporation for purposes of applying the same-country exception to insurance underwriting income derived by controlled foreign corporations. Rules are provided to treat remittances by the branch to its head office as dividends for purposes of imposing current U.S. tax on the remitted earnings.

The provision is effective for taxable years of foreign corporations beginning after December 31, 1988.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Foreign currency transactions

Present Law

Uniform residence-based sourcing and ordinary income and loss characterization rules apply to certain gains and losses on foreign currency-related forward contracts, futures contracts, options, and similar financial instruments, unless those instruments are marked to market under section 1256 at year-end. At the taxpayer's election, gain or loss on a forward, futures, or option which is a capital asset in the hands of the taxpayer, is not part of a straddle, and is identified by the taxpayer before the close of the day on which it is entered into, is capital, and not ordinary.

House Bill

The House bill sources foreign exchange gains and losses from transactions in forwards, futures, options, and similar financial instruments on the basis of the taxpayer's residence, and, unless the capital gain election is applicable, treats those gains as ordinary income, without regard to whether the instruments are or would be marked to market under section 1256 if held at year end. The bill gives the Secretary regulatory authority to relax the identification and anti-straddle conditions on making the capital gain election in the case of certain traders.

The House bill is effective for transactions acquired or entered into after July 14, 1988.

Senate Amendment

The Senate amendment is the same as the House bill. The Senate amendment is effective for transactions acquired or entered into after September 8, 1988.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with substantial modifications.

General rule

Subject to an election, the agreement generally retains current law treatment (as current law would be amended by title I (technical corrections) of the bill) of regulated futures contracts and nonequity options. That is, foreign currency-related regulated futures contracts and nonequity options are not treated as section 988 transactions if they are or would be marked to market under section 1256 if held at year-end.

Foreign currency-related forwards, other types of futures and options, and similar financial instruments are generally treated under the agreement as section 988 transactions without regard to whether the instruments are or would be marked to market under section 1256 if held at year end. The agreement therefore treats foreign exchange gain or loss on these instruments as foreign currency gain or loss, which is sourced on the basis of the taxpayer's residence, and, unless the capital gain election is applicable, characterized as ordinary income or loss, even if the instruments are or would be marked to market under section 1256 if held at year end. The conference agreement does not alter the identification and anti-straddle conditions of current law on making the capital gain election. The agreement does allow a special class of partnerships, called "qualified funds," to receive capital treatment on foreign exchange gains and losses from certain forwards and futures which would otherwise be section 988 transactions under the general rules.

Election to treat section 1256 futures and options as section 988 transactions

Under the agreement, a taxpayer (other than a partnership that has made a qualified fund election) may elect to treat regulated futures contracts and nonequity options (as those terms are defined in section 1256(g)(1) and (3)) as section 988 transactions without regard to whether the contracts or options are or would be marked to market under section 1256 if held at year end. As a result, exchange gains and losses from such contracts and options are treated as foreign currency gain or loss (similarly to exchange gains and losses on all other futures, forwards, options, and similar instruments), and therefore are treated as ordinary in character, and are sourced on the basis of residence. Thus under the agreement, a taxpayer that makes the election can use any type of forward contract, futures contract, option or similar instrument to hedge currency exposures on transactions giving rise to foreign exchange gain or loss, and be assured that the exchange gain or loss on the hedging instrument is sourced and characterized consistently with the exchange gain or loss on the hedged transaction.

In order to be effective for a taxable year, the election to treat regulated futures contracts and nonequity options as section 988 transactions in all events generally must be made on or before the first day of the taxable year, or, if later, the first day during the taxable year that the taxpayer holds such a contract or option. The agreement provides the Secretary with regulatory authority to permit elections after that day, however. The conferees intend that any regulations so providing will ensure that late elections are not used as a means of choosing the taxpayer's preferred rules for sourcing and characterizing gain or loss on a contract after the value of the contract has moved. For example, such regulations could require taxpayers making late elections to treat the contract as not a section 988 contract with respect to losses inherent in the contract prior to the election.

In the case of futures and options held by a partnership, the election is to be made separately by each partner. A similar rule applies to futures and options held by S corporations. The election cannot be made with respect to any income or loss of a partnership that has elected to be treated as a "qualified fund" eligible for the special treatment described below. However, a partner in a qualified fund may elect to treat gain or loss from regulated futures contracts and nonequity options (other than such income or loss the partner receives by virtue of being a partner in a qualified fund) as gain or loss from section 988 transactions.

Once made, the election applies to the taxpayer (for this purpose, the term "taxpayer" includes all persons with whom the income and loss of the person making the election is combined for purposes of computing federal income tax; for example, an election by one member of a consolidated group covers all other group members), with respect to all gains and losses on all regulated futures contracts and nonequity options recognized in the taxable year for which the election was made and all gains and losses on all regulated futures contracts and nonequity options recognized in subsequent taxable years, unless the election is revoked with the consent of the Secretary. The conferees anticipate that the Secretary will consent to the revocation of such an election by a taxpayer only upon recapture of the benefits that the taxpayer may have received (for example, through the deduction of ordinary losses that would have been nondeductible if capital) during the period for which the election was effective.

Treatment of instruments held by qualified funds

The conference agreement provides special rules for transactions in forward contracts, futures contracts, options, and similar instruments where they are held by certain "qualified funds," generally resulting in capital treatment for marked-to-market instruments falling within an expanded definition of the term "section 1256 contract."

Expansion of section 1256

For purposes of section 1256, the agreement expands the definition of section 1256 contracts to generally include all contracts held by qualified funds that are bank forwards: that is, foreign currency contracts (as that term is defined in section 1256(g)(2) of the Code), and any contract that would be a foreign currency contract but for the fact that it requires delivery of, or the settlement of which depends on the value of, a foreign currency which is a currency in which positions are *not* also traded on a so-called qualified board or exchange through regulated futures contracts (as defined in section 1256(g)(1)). In addition, the agreement generally treats as section 1256 contracts all contracts held by qualified funds that are foreign currency futures contracts: that is, regulated futures contracts which are traded on qualified boards or exchanges, as described in section 1256(g)(1), and other futures contracts to pay or receive nonfunctional currency or amounts determined by reference to one or more nonfunctional currencies, traded on or subject to the rules of a board or exchange *other than* a qualified board or exchange. Finally, the agreement provides the Treasury with regulatory authority to treat other similar instruments (for example, options) held by qualified funds as section 1256 contracts. The conferees do not anticipate that Treasury will use this regulatory authority to treat swaps as 1256 contracts under the qualified fund rules.

The agreement gives the Treasury regulatory authority to except forward and futures contracts from the expanded section 1256 contract category where, for example, the contracts are thinly traded or there are insufficient non-tax-motivated checks on the valuation process. The conferees anticipate that futures contracts will be eligible for treatment under the qualified fund rules as 1256 contracts if the particular board or exchange on which the contract is traded, whether foreign or domestic, has an appropriate daily marking to market system in place (similar to that which would satisfy the requirements of section 1256(g)(1)(A)) or the daily or month-end values of outstanding contracts on that exchange are otherwise readily ascertainable on a consistent and reliable basis.

Under the agreement, each contract held by a qualified fund and treated as a section 1256 contract under the above rules as well as each contract that is a section 1256 contract within the meaning of section 1256(g), will generally be subject to the rules of section 1256. For example, if held by the qualified fund at the close of the taxable year, it will be marked to market. That is, it shall be treated as sold for its fair market value on the last business day of such taxable year, any gain or loss shall be taken into account for the taxable year, and proper adjustment shall be made in the amount of any gain or loss subsequently realized to reflect gain or loss taken into account by reason of year-end marking to market (*see* sec. 1256(a)(1) and (2)). Capital gains and losses on contracts that are treated as section 1256 contracts under the agreement, however, will not receive 60/40 treatment under section 1256(a)(3). Instead, the gains and losses of qualified funds on these contracts will be short term capital gains and losses. Gains and losses of qualified funds on such contracts that are section 1256 contracts without regard to the agreement's rules will continue to be short term capital gain or loss to the extent of 40 percent of the gain or loss, and long term gain or loss to the extent of 60 percent of the gain or loss, to the extent that the 60/40 rule is otherwise applicable.

Definition of a qualified fund

A qualified fund under the agreement is an electing partnership meeting an ownership test, a principal activity test, and an income test designed to ensure that the special rules in the agreement are not used to mismatch offsetting currency-related gains and losses in a single return or a single group of related taxpayers. In order to be a qualified fund for a taxable year, a partnership must have met these tests in that taxable year and all prior taxable years beginning with the first year that the partnership elected to be treated as a qualified fund.

Ownership test.—The ownership test requires that a qualified fund have at least 20 unrelated partners during the entire taxable year. (Generally for purposes of the agreement, interests in a partnership held by persons related to each other (within the meaning of sections 267(b) and 707(b)) are be treated as if held by one person.) Except as provided in regulations, a fund with less than 20 unrelated partners generally will meet the requirement if there are partners which are themselves partnerships and the number of unrelated persons that ultimately participate (directly or indirectly) as partners in the qualified fund is 20 or more.

No one of the partners in a qualified fund may own more than 20 percent of the capital or profits interest in the partnership. In the case of an existing partnership (i.e., one in existence and principally engaged in trading commodity futures, forwards, and options on October 20, 1988, or with respect to which a registration statement indicating that the partnership was to be principally engaged in such trading was filed with the Securities and Exchange Commission on or before October 18, 1988) a partner may own up to the lesser of 33 and one-third percent of capital or profits interest in the partnership, or the lowest percentage previously owned by that partner after October 20, 1988, and still be deemed to meet the ownership test. Thus, for example, if the partnership share of a partner who owned 33 and one-third percent of capital or profits on October 20, 1988 is later reduced to 25 percent, generally that partner's share cannot subsequently be increased without causing the partnership to cease being a qualified fund.

There are two additional exceptions to the 20 percent limit on partnership interests owned by a single partner. First, that limit does not apply to an interest of a general partner if neither that partner, nor any person whose taxable income is combined with such general partner's taxable income in a consolidated return, has ordinary income or loss that is foreign currency gain or loss (as defined in section 988(b)). Thus, a general partner's share of profits or capital may be any percentage if none of that partner's ordinary income or loss is exchange gain or loss from a section 988 transaction. Any partner of the partnership that is itself a partnership will be subject to look through treatment for purposes of this provision. Thus, if a qualified fund has a general partner owning 50 percent of the qualified fund's profits and capital, and that general partner is itself a partnership, then none of the partners of the latter may have ordinary income or loss from foreign currency gain or loss.

Second, the 20 percent limit on partnership interests does not apply to a partner, general or limited, whose share of the partnership's income, gain, loss, deduction, or credit is not subject to federal income taxation (and thus would not be available to reduce income or gain subject to federal income taxation, or to reduce federal income taxes).

In computing a partner's interest in profits, income allocable to a general partner as incentive compensation and not deductible by the partnership shall be disregarded. For this purpose, the conferees intend to treat as compensation based on profits only those interests that result in the partner earning amounts disproportionate to its stated profits interest (that is, its interest in profits stated as a single, fixed percentage of partnership profits). For example, if a general partner has a stated 1 percent interest in partnership profits plus an overriding 20 percent interest in "new profits," defined in such a way that its profits interest in any one year could be as much as 100 percent, and in fact the percentage of profits actually received by the partner in one year can be expected at times to exceed 20 percent (but not on a regular basis), then such an arrangement generally does not disqualify the fund. On the other hand, if "new profits" are defined in such a way that the partner can be expected to earn, or does earn, over 20 percent of the profits of the fund in most taxable years of the partnership, then the conferees generally intend that the partnership not be treated as a qualified fund.

Activity test.—The activity test requires that a qualified fund's principal activity be the buying and selling of options, futures, or forwards with respect to commodities. The conferees intend that in appropriate circumstances, partnerships may be deemed to satisfy this test even though they may hold a substantial amount of debt instruments, in order, for example, to fund guaranteed payments to limited partners, or to collateralize obligations on margin accounts.

Income test.—At least 90 percent of the gross income of a qualified fund must be from interest, dividends, gain from the sale or disposition of capital assets held for the production of interest or dividends, and income and gains from commodities, futures, forwards, and options with respect to commodities. The agreement provides that a qualified fund shall have no more than a de minimis amount of gross income from the buying and selling of commodities (whether from sales, exchanges, or other dispositions), or from debt instruments that are section 988 transactions. The conferees understand that under regulations a partnership will not generally fail the de minimis test for qualified fund status if it acquires commodities for a short period for reasons beyond its control. For example, if the partnership has written a put option on a commodity, or a contract to take delivery on a commodity, that is subsequently exercised rather than closed out (e.g., exercise of put by the holder or inability to close out a particular futures contract because the change in that contract's value has exceeded the daily limit), leaving the partnership in possession of an actual commodity that it then disposes of at a gain, such gain shall generally meet the de minimis exception. In addition, partnerships in existence prior to the enactment of the agreement are not subject to the de minimis rule with respect to periods before the date of enactment. Therefore, a partnership that meets the 90 percent income test, the ownership test, and the principal activity test for the entire taxable year in which the date of enactment falls, and also meets the de minimis test for the post-enactment portion of that taxable year, will be eligible for qualified fund treatment.

Effect of failure to meet qualified fund definition

In order to be treated as a qualified fund for the taxable year a partnership must make an election, on or before the later of the first day of the taxable year, or the first day in the taxable year that the partnership holds a section 1256 contract (under the expanded definition). Once the election is made, the partnership is treated as a qualified fund for that year and all subsequent taxable years, unless it fails one or more of the qualification tests. The conferees do not intend for a partnership to elect qualified fund status for a taxable year based on an ex post analysis of its performance over the year. Thus, for example, where an existing partnership first wishes to make the election for a year subsequent to its first year of buying and selling commodity futures, forwards, and options, the conferees expect that the Secretary will require the partnership to mark to market all instruments acquired or entered into prior to the first year of the election and still held at the beginning of that first election year, if the treatment of gains and losses on those held-over contracts would be changed by the making of the election.

In addition, the agreement provides generally that if a partnership, which elected to be treated as a qualified fund in the current taxable year or any prior taxable year, fails to meet the qualified fund definition for the current taxable year, the character of its gain or loss on its section 1256 contracts (as that term is expanded under the provision) will be dependent on whether the gains and losses of the partnership for the taxable year from all such contracts result, when combined, in a net gain or a net loss. If the result is a net gain, then that gain is characterized as ordinary; if the result is a net loss, that loss is characterized under the rules that would have applied if the partnership had not ceased to be a qualified fund.

However, the agreement provides that if a partnership that was a qualified fund in a prior taxable year (or that filed a statement declaring its intent to be treated as a qualified fund with respect to the current taxable year or any prior taxable year) fails to meet the qualified fund definition during the current taxable year, the Secretary of the Treasury determines that the failure was inadvertent, the partnership takes steps within a reasonable time to meet the failed requirements, and the partnership agrees to make such adjustments (including adjustments with respect to the partners) as may be required by the Secretary with respect to the period of inadvertent failure, then the above rule will not apply and the partnership will be treated as if it met the definition of a qualified fund for the entire taxable year.

For example, if a partner with a 20 percent profits interest becomes a 22 percent partner by virtue of a redemption by the partnership of some or all of another partner's interest, over which neither the partnership nor the first partner had any control, and the 22 percent partner's share is reduced within a reasonable time (e.g., by sale of a partnership interest equal to at least 2 percent to another partner with less than an 18 percent profits interest, or redemption of the 22 percent partner's interest to the extent of 2 percent (assuming such redemption does not push another existing partner's profits interest over 20 percent)), the partnership will continue to be treated as a qualified fund. In the case of an existing partnership (as that term is defined above), the conferees expect that any existing partnership agreement restricting the right of the partnership to unilaterally take the steps necessary to rectify such an inadvertent failure of the qualified fund test will be taken into account by the Secretary in determining whether the inadvertent failure was cured within a reasonable time.

Mixed straddles

Finally, the conference agreement provides that the regulatory authority of the Secretary under section 1092(b), namely, to prescribe such regulations with respect to gain or loss on positions which are a part of a straddle as may be appropriate to carry out the purposes of sections 1092 and 263(g), shall include the authority relating to the timing and character of gains and losses in case of straddles where at least one position is ordinary and at least one position is capital.

The conferees understand that a taxpayer may hold a straddle containing one or more currency positions that would normally give rise to capital gain or loss and one or more positions that would normally give rise to ordinary income or loss. For example, an investor might hold a long Deutsche mark futures contract traded on a U.S. commodities exchange and an offsetting short Deutsche mark forward contract traded in the interbank market. The forward contract would give rise to ordinary income or loss under the agreement and, in the absence of an election to receive ordinary treatment, the futures contract would give rise to 60 percent long-term, 40 percent short-term capital gain or loss treatment.

The conferees intend that such straddles be subject to the mixed straddle regulations prescribed under section 1092(b), with appropriate modifications to take account of the fact that one or more of the straddle positions would normally give rise to ordinary income or loss rather than capital gain or loss. Under the mixed straddle regulations, a taxpayer who so elects may either (1) offset gains and losses from positions which are part of mixed straddles by separately identifying each mixed straddle to which such treatment applies, or (2) establish a mixed straddle account with respect to a class of activities for which gains or losses will be recognized and offset on a periodic basis. The conferees expect that, as under the current regulations, 60/40 treatment will apply only to net gain or loss from the transactions included in the identified mixed straddle or the account and only to the extent attributable to section 1256 contracts giving rise to capital gain or loss (e.g., regulated futures contracts or nonequity options in foreign currency, traded on U.S. exchanges and subject to mark-to-market taxation). Under the current regulations applicable to a mixed straddle account, not more than 50 percent of any net gain may be treated as long-term capital gain and not more than 40 percent of any net loss may be treated as short-term capital loss. In the case of a mixed straddle account containing currency positions, the conferees anticipate that not more than 40 percent of any net foreign exchange loss from the account may be treated as ordinary loss.

Effective date

The conference agreement is generally effective for contracts acquired or entered into after October 21, 1988. The agreement provides that no election to treat regulated futures contracts and nonequity options as section 988 transactions, and no election to treat a partnership as a qualified fund, need be made prior to 30 days from the enactment of the agreement. As described above, the rule prohibiting qualified funds from having a de minimis amount of income from commodities (rather than forwards, futures, and options with respect to commodities) does not apply to periods before the date of enactment. Also, the 20 percent limit on shareholders in a qualified fund will be considered met by an existing partnership if no partner in such a fund owns a percentage interest in the capital or profits of the partnership greater than 33 and one-third percent (or, if lower, the lowest percentage interest owned by the partner after October 20, 1988).

6. Chain deficit rule for controlled foreign corporations

Present Law

Deficits generated by a controlled foreign corporation cannot reduce the subpart F income of any other controlled foreign corporation. Under title I (technical corrections) of the bill, these deficits could reduce the subpart F income of another controlled foreign corporation in limited circumstances, generally when the deficits are attributable to categories of business activities the income from which is subject to current tax under subpart F, and the income sought to be reduced is attributable to the same type of activity as the activity giving rise to the deficit. Insurance income is a type of income that is subject to subpart F unless it is attributable to the insurance of risks in the same country in which the corporation is organized.

House Bill

No provision.

Senate Amendment

The Senate amendment provides an election to controlled foreign corporations to treat same-country insurance income as subpart F income so long as all related, controlled foreign corporations organized in the same country elect (thus making same-country insurance income eligible for reduction under the deficit rules of subpart F), and, for purposes of determining whether investment income is derived from qualified activities, treats electing corporations as one corporation.

The Senate amendment is effective as if included in the Tax Reform Act of 1986.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Qualified possession source investment income

Present Law

A possession tax credit is available on qualified possession source investment income (QPSII) of certain electing domestic corporations engaged in a trade or business in Puerto Rico or the U.S. Virgins Islands. In order to be QPSII, investment income generally must be, among other things, attributable to investment in a possession where a trade or business is conducted, for use in that possession. Under the 1986 Act, investments in certain financial intermediaries are treated as investments for use in Puerto Rico if the intermediary makes appropriate investments in qualified Caribbean Basin countries, which do not include the U.S. Virgin Islands.

House Bill

No provision.

Senate Amendment

The Senate amendment treats the U.S. Virgin Islands as a qualified Caribbean Basin country for purposes of determining whether investments in financial intermediaries give rise to QPSII.

The Senate amendment is effective for investments made after date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

8. Banks organized in U.S. possessions

Present Law

Certain non-Guamanian possession banks are subject to net-basis U.S. income tax and to branch level taxes with respect to interest on U.S. government obligations, regardless of whether the banks have an actual trade or business in the United States.

House Bill

No provision.

Senate Amendment

The Senate amendment excludes banks organized and doing business in any U.S. possession from net-basis U.S. taxation on interest on U.S. government obligations that is portfolio interest, and from the branch level taxes on earnings that arise from, and interest expense that is allocated against, interest income on U.S. obligations derived by those banks (unless those banks are engaged in a U.S. trade or business and the interest is actually effectively connected therewith).

The Senate amendment is effective in taxable years beginning after December 31, 1988.

Conference Agreement

The conference agreement follows the Senate amendment.

9. Gambling winnings of nonresident aliens

Present Law

A 30-percent withholding tax is imposed on certain U.S. source income not effectively connected with a U.S. trade or business. Subject to exceptions, the IRS collects this tax on gambling winnings of nonresident aliens. Currently, the IRS does not collect this tax on winnings from certain "table games."

House Bill

The House bill excludes winnings from blackjack, roulette, baccarat, craps, and big six wheel from the 30 percent withholding tax, except to the extent provided in regulations.

The House bill is effective for winnings after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

10. Controlled foreign insurance corporations owned by U.S. persons

Present Law

Controlled foreign corporations engaged in the insurance business in the United States are subject to branch level taxes even if they are owned by U.S. persons. Reorganization of these corporations as U.S. corporations would require that their accumulated earnings and profits be deemed distributed as dividends to their U.S. shareholders in order for those reorganizations to be considered nonrecognition events.

House Bill

No provision.

Senate Amendment

The Senate amendment provides an election to be treated as a U.S. corporation to controlled foreign corporations engaged in the insurance business. The amendment provides rules to treat dividends paid out of earnings and profits of pre-election years as coming from a foreign corporation, and adopts anti-abuse rules to prevent the repatriation of pre-election period earnings and profits without the current payment of U.S. tax and to impose the branch profits tax in the event earnings and profits attributable to 1987 are remitted abroad. The amendment also requires the payment by an electing corporation of a tax equal to three-quarters of one percent of capital and surplus accumulated as of December 31, 1987 (but limited to $1,500,000), in lieu of causing earnings and profits accumulated as of that date to be deemed distributed.

The Senate amendment is effective in taxable years beginning after December 31, 1987.

Conference Agreement

The conference agreement follows the Senate amendment.

11. Tax exemption for Enjebi Community Trust fund

Present Law

The Enjebi Community Trust Fund was established in section 103(k) of the Compact of Free Association Act of 1985 (P.L. 99-239) to provide a means of financing the future rehabilitation of Enjebi Island in the Enewetak Atoll, which was used by the United States as ground zero for numerous nuclear weapons tests conducted in the 1940's and 1950's.

House Bill

The House bill exempts earnings on and distributions from the Enjebi Community Trust Fund from Federal, State, and local taxation.

The House bill is effective in all open taxable years.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

12. Cost-of-living allowances for judicial branch employees outside the United States

Present Law

Civilian officers or employees of the U.S. government stationed outside the contiguous 48 states and the District of Columbia can exclude from gross income cost-of-living allowances received in accordance with regulations approved by the President. Cost-of-living allowances paid to federal court employees of the U.S. government (after October 12, 1987) are not received under regulations approved by the President and are not excludable from gross income.

House Bill

No provision.

Senate Amendment

The Senate amendment excludes from gross income cost-of-living allowances received by judicial branch employees stationed outside the contiguous 48 states and the District of Columbia if they are received under regulations approved by the President or under rules similar to such regulations.

The Senate amendment is effective for amounts received after October 12, 1987.

Conference Agreement

The conference agreement follows the Senate amendment.

13. Dividends paid by U.S. corporations

Present Law

The 1986 Act made dividends paid by U.S. corporations (other than sec. 936 corporations) to U.S. shareholders U.S. source, even if the U.S. corporation is doing most of its business outside the United States (a so-called "80/20 company"). A technical correction contained in H.R. 4333 and S. 2238 clarifies that the 1986 Act was to be effective for dividends paid in taxable years beginning after December 31, 1986.

House Bill

No provision.

Senate Amendment

The Senate amendment provides an election to have the 1986 Act's provision making dividends paid by U.S. corporations to U.S. shareholders U.S. source effective for dividends paid after December 31, 1986.

Conference Agreement

The conference agreement follows the Senate amendment.

14. Study on the definition of a resident alien

Present Law

The Tax Reform Act of 1984 established objective rules for defining a resident alien for U.S. income tax purposes. Generally, an individual is a resident alien if he or she is lawfully accorded the privilege of residing permanently in the United States, or is present in the United States for a prescribed period of time in the current year or a sufficient period of time in the current and previous two years.

House Bill

No provision.

Senate Amendment

The Senate amendment requires the Treasury Department to complete a study before May 1, 1989 of the Code definition of resident alien, in order to examine the administrability of the definition, its effect on investment flows into the United States, the definitions used by U.S. trading partners, the relationship of the definition with U.S. treaties, and the estimated revenue impact of changing the definition.

Conference Agreement

The conference agreement follows the Senate amendment.

15. Bermuda and Barbados income tax treaties

Present Law

The United States taxes U.S. source (and some foreign source) insurance income derived by a foreign person either as income effectively connected with a U.S. business, which is subject to net basis taxation, or as income not so connected, which is subject to a gross basis excise tax. The U.S.-Barbados income tax treaty, among other things, waives the gross basis excise tax when the income is derived by qualifying Barbadian corporations. The pending U.S.-Bermuda income tax treaty, as it would be modified by a proposed reservation, also would waive the gross basis excise tax when the income is derived by qualifying Bermudian corporations, but only for premiums paid after 1985 and before 1990.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that neither the Barbados nor Bermuda income tax treaty with the United States, if either or both are in force on December 31, 1989, shall prevent application of the United States' gross basis excise tax to premiums paid on or after January 1, 1990 (or, if paid prior to that date, to premiums allocable to insurance coverage for taxable years beginning on or after January 1, 1990). The provision is effective even if one of the treaties enters into force after date of enactment, unless such treaty specifically refers to this provision, in which case the treaty would apply.

Conference Agreement

The conference agreement follows the Senate amendment with the clarification that the provision applies with respect to any premium, regardless of when paid, that is allocable to insurance coverage for periods after December 31, 1989.

16. Treatment of certain awards by the District Court of Guam

Present Law

Currently, Guam is required to use the tax laws of the United States as its local income tax system, which is accomplished generally by substituting "Guam" for "the United States" where appropriate in the Internal Revenue Code. This system of taxation is known as the "mirror system." The Reform Act provided that Guam will have the authority to establish its own tax laws, with certain restrictions, if an implementing agreement is in place between Guam and the United States to coordinate the Guam and U.S. tax systems. Because there currently is no implementing agreement in place, however, Guam must impose income tax under the mirror system; the government of Guam generally lacks authority to determine local tax law independent of U.S. tax rules until such time as an implementing agreement is in place. For example, Guam currently lacks the authority to exclude items from gross income where such items are not so excluded under the mirror system.

Section 204 of the Omnibus Territories Act of 1977 (P.L. 95-134) granted the District Court of Guam jurisdiction to award former landowners, and their heirs and legatees, compensation for certain lands on Guam which the United States obtained from those landowners in the 1940s without adequate compensation. The claimants in this controversy will receive compensation under a settlement that has been reached with the United States. The settlement has resulted, to date, in the fixing of an amount ultimately to be distributed (along with interest on that amount accruing after the date the amount was fixed) to the claimants. The income from this settlement is subject to taxation by the United States and Guam to the extent provided by normal application of U.S. tax law and the Guam mirror system. If any of this income is subject to taxation by the United States, taxes collected by the United States would generally be required to be covered over to the treasury of Guam.

Conference Agreement

The conference agreement provides, for purposes of the internal revenue laws of both Guam and the United States, that gross income does not include amounts received pursuant to the claims over which the District Court of Guam has jurisdiction by reason of section 204 of the Omnibus Territories Act of 1977, thus rendering exempt from tax the amounts these claimants receive on their claims against the United States. Exempt income includes the previously fixed settlement amount, plus interest or earnings thereon, except that to the extent an award has been constructively received by a claimant, interest or earnings accruing after constructive receipt are not intended to be exempted. The conferees intend that the normal rules for determining when income is constructively received shall apply. The provision is effective for taxable years beginning after December 31, 1985.

G. Estate Tax Provisions

1. Special use valuation of farm property for estate tax purposes

Present Law

If the executor so elects, the value of real property used as a farm or in another trade or business is its value in such use rather than in its highest and best use. A recapture tax is imposed if the person receiving the property ceases using it in its qualified use within 10 years (15 years for individuals dying before 1982) after the death of the person in whose estate the property was specially valued.

House Bill

The House bill provides that a surviving spouse's cash rental of specially valued real property to a member of the spouse's family is not treated as a cessation of a qualified use. The provision is effective for rentals occurring after date of enactment.

Senate Amendment

The Senate amendment is generally the same as the House bill, except that the amendment is effective for rentals occurring after December 31, 1976. The statute of limitations is waived for claims filed within one year after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Treatment of joint and survivor annuities under QTIP rules

Present Law

The Federal gift tax applies to gifts of property to the extent that the value of the gifts exceeds permitted deductions. A taxable gift generally occurs with respect to an annuity when the donor irrevocably designates a beneficiary.

A marital deduction is allowed for Federal estate and gift tax purposes for an interest in property passing to a spouse if that interest is not terminable (i.e., it does not terminate and pass to a person other than the spouse). A special rule, that is applicable to qualified terminable interest property (QTIP), allows a marital deduction where the donee spouse only has an income interest in the property if an election is made to include the property in his or her estate and any Federal estate tax is paid out of the QTIP.

House Bill

The transfer to a spouse of an interest in a joint and survivor annuity in which only the spouses have the right to receive any payments prior to the death of the last spouse to die qualifies for a marital deduction for Federal estate and gift tax purposes under the QTIP rule. Such transfer does not qualify, however, if either the donor or the executor, as the case may be, irrevocably elects out of QTIP treatment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

H. Tax-Exempt Bonds

1. Clarification of definition of manufacturing for qualified small-issue bonds

Present Law

States and local governments may issue qualified small-issue tax-exempt private activity bonds to finance manufacturing facilities. A manufacturing facility is defined as a facility for the production of tangible personal property. A *de minimus* amount of space in a manufacturing plant which is devoted to offices may be disregarded if the office space is directly related to the manufacturing process.

House Bill

The House bill clarifies that up to 25 percent of the proceeds of a qualified small issue may be used to finance ancillary activities which are carried out at the manufacturing site. All such ancillary activities must be subordinate and integral to the manufacturing process.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Extension of minimum period for calculating TRAN safe-harbor compliance

Present Law

Arbitrage earnings from investment of tax and revenue anticipation note (TRAN) proceeds must be rebated to the Federal Government under the same rules as apply to other tax-exempt bonds (Code sec. 148). A special safe-harbor calculation is provided, however, for determining whether TRAN issues are exempt from rebate under a general exception for tax-exempt bonds the gross proceeds of which are spent for the governmental purpose of the borrowing within six months after the bonds are issued. Under this safe harbor, TRAN net proceeds are treated as so spent if the issuer's cumulative cash flow deficit for the period beginning on the date the notes are issued and ending on the earliest of (a) the maturity date of the TRANs, (b) the date that is six months after the TRANs are issued, or (c) the date of computation of the issuers cash flow deficit, exceeds 90 percent of the TRAN proceeds. Final rebate payments for bond issues are due 60 days after the bonds are redeemed.

House Bill

Under the bill the TRAN arbitrage rebate safe-harbor is amended to provide that, in the case of TRANs having a maturity of less than six months, the period for determining the issuer's cumulative cash flow deficit will be the period beginning on the date the bonds are issued and ending on the earlier of (a) the date that is six months after the TRANs are issued or (b) the date of computation of the issuers cash flow deficit, exceeds 90 percent of the TRAN proceeds.

The bill's provision (like the TRAN safe-harbor generally) does not affect the determination of whether an issuer qualifies for a temporary period during which higher yielding investments may be made. That determination continues to be made under Treasury Regulation sec. 1.103-14(c); therefore, to qualify for a temporary period, issuers will continue to be required to satisfy the cumulative cash flow deficit calculation of that regulation before the maturity date of each TRAN issue.

The bill further provides that the final rebate payment on TRAN issues having a maturity of less than six months will be due no earlier than eight months after the date of issue.

The provision applies to TRANs issued after the date of the bill's enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Application of security interest test to bond financing of hazardous waste clean-up funds

Present Law

State and local governments may issue tax-exempt bonds to finance governmental activities, but may issue tax-exempt private activity bonds only for specified purposes. Several States are considering issuance of tax-exempt bonds to finance hazardous waste clean-up activities. Present law is unclear as to when these bonds are governmental bonds if the proceeds are used to finance activities on private property and where reimbursement may be sought from private parties.

House Bill

No provision.

Senate Amendment

The Senate amendment directs the Treasury Department to issue guidance concerning the application of the private activity bond test to tax-exempt bond financing for State programs that finance hazardous waste cleanup activities. The guidance must be provided before January 1, 1989.

Conference Agreement

The conference agreement follows the Senate amendment.

4. Tax-exempt financing for certain high-speed rail facilities

Present Law

States and local governments are permitted to issue tax-exempt private activity bonds to finance certain exempt facilities, which include airports, docks and wharves, mass commuting facilities, and sewage facilities, among others. With the exception of bonds for airports, docks and wharves, and governmentally owned solid waste facilities, exempt-facility bonds are subject to State private activity volume limitations. To qualify for tax-exempt financing, airport, dock and wharf, and mass commuting facilities must be governmentally owned.

House Bill

No provision.

Senate Amendment

The amendment creates a new category of exempt-facility bond: bonds to finance intercity high-speed rail facilities.[1] The term "high-speed rail facility" includes ground transportation facilities which utilize magnetic levitation technology. To be a qualifying facility, it must be reasonably expected that trains, carrying passengers and their baggage, will operate on the rail facility that is bond financed at average speeds in excess of 150 miles per hour between stations.

The amendment accords high-speed rail facility bonds the same treatment as present law accords airport bonds, with three exceptions. First, the facilities financed with the proceeds of such bonds need not be governmentally owned. However, any private owner must make an irrevocable election not to claim depreciation or any tax credit with respect to any bond-financed property.

Second, twenty-five percent of each issue must receive an allocation from State private activity bond volume limitation. If the facility is located in two or more States, this requirement must be met on a State by State basis for the financing of the facilities located within each State.

Third, any proceeds of an issue not spent within three years of the date of issue must be used to redeem outstanding bonds. Redemption must occur no later than six months after the date that is three years from the date of issue.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Clarification of Treasury Department arbitrage rebate regulatory authority with respect to governmental bonds

Present Law

Issuers of tax-exempt bonds are required to rebate to the Federal Government arbitrage profits on investments unrelated to the governmental purpose of the borrowing (Code sec. 148). The Treasury Department currently is drafting regulations interpreting and providing administrative guidance on this requirement.

House Bill

Committee Report language is provided on two points. First, it states the understanding that the Treasury Department is authorized to create safe harbors in certain instances for calculating rebate payments with respect to governmental bonds that remain subject to the rebate requirements. Any safe harbor rules adopted by Treasury should address factual circumstances unique to governmental financings and accounting rather than relying on, *inter alia*, the fact that in many but not all economic circumstances yield curve differentials have resulted in lower interest rates on short-term investments than on investments having longer maturities. Second, it states the Congressional intent that the Treasury Department is to have as a primary objective in promulgating arbitrage rebate regulations for governmental bonds that remain subject to the rebate requirement the adoption of regulations that are workable and understandable to the governmental units that must comply with them.

---

[1] Rolling stock may not be financed with bond proceeds.

The provision applies as if included in the Tax Reform Act of 1986.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

6. Application of arbitrage rebate requirement to bona fide debt service funds

Present Law

Issuers of tax-exempt bonds are required to rebate to the Federal Government arbitrage earnings on investments unrelated to the governmental purpose of the borrowing (Code sec. 148). No rebate is required with respect to an issue if all gross proceeds of the issue are spent for the governmental purpose of the borrowing within six months after the bonds are issued. At the election of the issuer, amounts invested in a *bona fide* debt service fund (i.e., a fund to satisfy current debt service on the bonds) are exempt from the rebate requirement if the gross earnings on the fund are less than $100,000.

House Bill

Under the House bill, the present-law election to be exempt from the arbitrage rebate requirement for *bona-fide* debt funds having gross earnings of less than $100,000 is made mandatory.

The bill further provides that the $100,000 gross earnings limit does not apply to issues of governmental bonds having a weighted average maturity of five years or more and bearing interest at rates that do not vary during the term of the bonds.

The provision applies to bonds issued after the date of the bill's enactment.

Senate Amendment

The Senate amendment is the same as the House bill, except for the effective date.

Under the Senate amendment, issuers of outstanding governmental fixed rate bonds would be allowed a one-time election to apply the new rule to amounts deposited after the date of the bill's enactment in *bona fide* debt service funds for bonds issued after August 31, 1986.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Certain volunteer fire departments to qualify for tax-exempt financing

Present Law

Tax-exempt bonds may be issued to finance firehouses and fire fighting equipment for volunteer fire departments if the fire departments are the only organization providing firefighting services to the jurisdiction which they serve and if they are required by written agreement with the governmental unit to provide such services (Code sec. 150).

The Treasury Department ruling position is that land may not be financed with these tax-exempt bonds, even if the land is functionally related and subordinate to a firehouse being financed.

House Bill

The House bill provides an exemption from the requirement that a volunteer fire department be the exclusive provider of firefighting services in its service area. To qualify for tax-exempt financing under this exception the governmental unit served by such volunteer fire departments must have been served continuously and exclusively by more than one such fire department since January 1, 1981.

The bill also clarifies that land which is functionally related and subordinate to a firehouse qualifying for tax-exempt financing may be financed with tax-exempt bonds.

The provision applies to bonds issued after the date of the bill's enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

8. Disregard of pooled financings in determination of qualification for small-issuer exception

Present Law

Interest on State and local government bonds generally is tax-exempt. To qualify for tax-exemption, certain arbitrage restrictions must be satisfied with respect to the earnings on bond proceeds. Among the requirements is that nonpurpose arbitrage earnings must be rebated to the Federal Government. A special exemption from the rebate requirement is provided for bonds (other than private activity bonds) issued by governmental units with general taxing powers where the governmental unit does not issue more than $5 million of bonds (other than private activity bonds) during the calendar year.

If a State or local government issues bonds, the proceeds of which are to be used to make loans to other persons, the bonds are a pooled financing. Regardless of the ultimate user of the funds from a pooled financing, the bonds issued count towards the determination of whether the issuer qualifies as a small-issuer.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that, in the case of pooled financings where the ultimate borrowers are governmental units with general taxing powers, and the issuer of the bonds is not an ultimate borrower, for the purposes of determining whether the issuer qualifies under the small-issuer exception, with respect to its nonpooled financing issues, the bonds comprising the pooled financing shall not be counted towards the $5 million limit.

The provision is effective for bonds issued after December 31, 1988.

Conference Agreement

The conference agreement follows the Senate amendment.

I. Exempt Organizations

1. Effective date for UBIT treatment of income from certain games of chance

Present Law

Section 311 of the Deficit Reduction Act of 1984 provided that the unrelated business income tax (UBIT) does not apply to income of a tax-exempt organization derived from conducting a game of chance in a State having a statute, in effect as of October 5, 1983, providing that only nonprofit organizations could conduct such activities; this provision applied to such income derived after June 30, 1981. However, the technical corrections title of the Tax Reform Act of 1986 (sec. 1834) specified that the only State law to which the 1984 Act provision was intended to apply was a particular North Dakota law. Accordingly, such income derived by tax-exempt organizations in other States was treated as not subject to UBIT pursuant to the 1984 Act provision, but was retroactively treated as taxable by the 1986 Act.

House Bill

No provision.

Senate Amendment

The 1986 Act technical correction described under Present Law is made effective for games of chance conducted after October 22, 1986 (the date of enactment of the 1986 Act technical correction). As a result, the treatment of income derived by tax-exempt organizations from games of chance conducted prior to October 23, 1986 is governed by section 311 of the Deficit Reduction Act of 1984 as originally enacted.

This provision is effective (with respect to games of chance conducted prior to October 23, 1986) on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Purchasing of insurance by tax-exempt hospital service organizations

Present Law

Section 501(e) provides tax-exempt status for hospital service organizations operated solely to perform, on a centralized basis, one or more of the following enumerated services: purchasing, data processing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel services.

House Bill

No provision.

Senate Amendment

The provision clarifies that the purchasing activities that may be carried on by a tax-exempt hospital service organization include the acquisition, on a group basis, of insurance (such as malpractice and general liability insurance) for its hospital members. The provision applies to purchases made before, on, or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

3. Determination of operating foundation status for certain purposes

Present Law

Section 302 of the Deficit Reduction Act of 1984 exempted certain private operating foundations from the section 4940 excise tax on net investment income of private foundations. The exempted organizations include any private foundation that constituted an operating foundation (as defined in sec. 4942(j)(3)) as of January 1, 1983 and that met certain other requirements.

House Bill

For purposes of section 302(c)(3) of the Deficit Reduction Act of 1984, a private foundation that constituted an operating foundation (as defined in sec. 4942(j)(3)) for its last taxable year ending before January 1, 1983 is treated as constituting an operating foundation as of January 1, 1983 and therefore as meeting the requirements of section 4940(d)(2)(B). This provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

4. Treatment of exempt organization expenditures to influence the nomination or appointment of individuals to nonelective public office

Present Law

A charity or other tax-exempt organization described in section 501(c) is treated as having income subject to tax (under sec. 527(b)) in an amount equal to the lesser of (1) its expenditures for "exempt function" activities or (2) its net investment income (sec. 527(f)). For this purpose, "exempt function" includes influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office, whether such individual is selected, nominated, elected, or appointed (sec. 527(e)(2)).

The IRS recently interpreted this statutory definition as including activities seeking to influence the confirmation by the U.S. Senate of an individual nominated to serve as a Federal judge. The IRS also concluded that under present law, such activities constitute attempting to influence legislation within the meanings of sections 501(c)(3), 501(h), and 4911.

House Bill

No provision.

Senate Amendment

The term "exempt function" does not include, for purposes of section 527(f), the function of influencing or attempting to influence the selection, nomination, or appointment of an individual to any Federal, State, or local nonelective public office. As a result, tax-exempt organization described in section 501(c) could make expenditures for such purpose without triggering tax under section 527.

The provision does not modify existing limitations on political campaign activities applicable to various types of section 501(c) organizations, such as the prohibition on political campaign activities by section 501(c)(3) charitable organizations, or existing limitations on attempting to influence legislation (lobbying) by such organizations. Also, the provision does not affect the definition of lobbying for purposes of such limitations (e.g., in sec. 501(c)(3)).

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the House bill (i.e., no provision).

5. Discharge of indebtedness income of rural mutual or cooperative utility companies

Present Law

Under present law, a mutual or cooperative telephone, electric or water company qualifies for exemption from Federal income tax if at least 85 percent of its gross income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. Gross income of a taxpayer generally includes income from discharge of indebtedness.

House Bill

The 85-percent test would be determined without regard to any discharge of indebtedness income arising in 1987, 1988, or 1989 on debt that either originated with, or is guaranteed by, the Federal Government.

The provision applies to discharge of indebtedness income realized after December 31, 1986, and before January 1, 1990.

Senate Amendment

The 85-percent test would be determined without regard to any discharge of handedness income arising pursuant to sales of indebtedness under section 1001 of the Budget Reconciliation Act of 1986.

The provision applies to sales before, on, or after the date of enactment.

Conference Agreement

The conference agreement follows the House bill.

J. Taxpayer Bill of Rights

1. Disclosure of rights of taxpayers

Present Law

The Internal Revenue Service (IRS) provides information to taxpayers in various notices and publications. There is no statutory requirement that the IRS provide a written statement of the rights of the taxpayer and the obligations of the IRS during the tax dispute resolution process.

House Bill

No provision.

Senate Amendment

When the IRS contacts a taxpayer concerning the determination or collection of any tax, the IRS is required to provide a written statement of the rights of the taxpayer and the obligations of the IRS during the audit, appeals, refund, and collection processes. In addition, the IRS is required to take such actions as the IRS considers necessary to ensure that taxpayers are not sent multiple statements as a result of a single audit, proposed deficiency, or collection action. The statement need not be provided with tax forms.

The IRS must prepare the written statement of rights of the taxpayer and obligations of the IRS not later than 180 days after the date of enactment. The written statement may not be distributed to taxpayers until 90 days after the date it is transmitted to Congress.

Conference Agreement

The conference agreement generally follows the Senate amendment, except that the provision prohibiting distribution of the written statement to the public until 90 days after it is transmitted to Congress is deleted. This provision was deleted so that the IRS may continue to distribute Publication 1, Your Rights as a Taxpayer, while it is being revised to conform to the provisions of this Taxpayer Bill of Rights. All revisions to that publication must be submitted to Congress.

2. Procedures involving taxpayer interviews

Present Law

Reasonable time and place.—The Code provides that the IRS shall select a reasonable time and place for an examination of a taxpayer. No regulations have been promulgated elaborating on this provision.

Recordings.—No statutory provision governs audio recordings of IRS interviews, although the IRS generally permits a taxpayer to make an audio recording of an interview if prior notice to the IRS is given.

IRS explanation.—The IRS has a general practice of providing written explanatory materials to taxpayers in advance of the initial audit interview.

Taxpayer representatives.—If a power of attorney has been executed properly in favor of a person eligible to practice before the IRS, the IRS permits the person to represent the taxpayer during all stages of the administrative process.

House Bill

No provision.

Senate Amendment

Reasonable time and place.—The IRS is required to publish within one year of the date of enactment regulations enumerating standards for determining whether the selection of a time and place for interviewing a taxpayer is reasonable. These regulations are to provide that it is generally not reasonable for the IRS to require a taxpayer to attend an examination at an IRS office within the assigned district other than the office located closest to the taxpayer's home. Similarly, it is generally not reasonable for the IRS to audit a taxpayer at his or her place of business if the business is so small that doing so essentially requires the taxpayer to close the business. This does not preclude the IRS from going to the taxpayer's place of business to establish facts that can only be established by a direct visit, such as inventory and asset verifications. In determining the reasonableness of the time and place of an interview, the regulations are to take into account the possibility of physical danger to an IRS agent.

Recordings.—A taxpayer is permitted, upon advance notice to the IRS, to make an audio recording of an in-person interview at the taxpayer's own expense. IRS employees also are authorized to record taxpayer interviews, provided the taxpayer receives prior notice of such recording and is supplied a copy or a transcript of the recording upon request and payment of the costs of the copy or transcript.

IRS explanation.—Prior to initial in-person audit interviews, the IRS must explain to taxpayers the audit process and taxpayers' rights under that process. In addition, prior to initial in-person collection interviews, the IRS must explain the collection process and taxpayers' rights under that process. For this purpose, routine telephone conversations initiated by either the taxpayer or the IRS are not considered initial interviews. A written statement handed to the taxpayer at an audit or collection interview or within a short time before the interview is sufficient. The explanation (whether written or oral) must provide that the taxpayer has the right to suspend the interview to consult with a qualified representative. If the taxpayer's case has been referred to the IRS Criminal Investigation Division, the IRS must notify the taxpayer of such referral at the interview.

Taxpayer representatives.—The bill provides that a taxpayer may be represented during a taxpayer interview by any attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person permitted to represent a taxpayer before the IRS, who is not disbarred or suspended from practice before the IRS and who has a properly executed power of attorney from the taxpayer. Thus, the taxpayer may be represented by anyone currently authorized to do so under Circular 230.

If a taxpayer clearly states during an interview with the IRS (other than an interview pursuant to an administrative summons) that the taxpayer wishes to consult with that representative, the interview must be suspended to afford the taxpayer a reasonable opportunity to consult with the representative. Absent an administrative summons, a taxpayer cannot be required to accompany the representative to an interview. The IRS may continue to request that taxpayers voluntarily attend interviews.

The suspension procedure provided by the provision is to be available to facilitate taxpayers' access to their representatives and not to delay needlessly the interview process. It is intended that in instances of abuse of this process (such as repeated suspensions of interviews to contact different representatives) the IRS may issue an administrative summons.

The IRS may directly notify a taxpayer that the taxpayer's representative is responsible for unreasonable delay or hindrance, request that the taxpayer appear for an interview, and inform the taxpayer that an administrative summons requiring the taxpayer's attendance at an interview may be issued.

The provisions relating to taxpayer interviews do not apply to criminal investigations or investigations relating to the integrity of any officer or employee of the IRS.

The provisions relating to taxpayer interviews apply to interviews conducted on or after the date that is 30 days after the date of enactment.

Conference Agreement

Reasonable time and place.—The conference agreement follows the Senate amendment, effective for interviews conducted on or after the 90th day after the date of enactment. The IRS must publish regulations within one year enumerating standards for selecting a reasonable time and place for interviewing a taxpayer.

Recordings.—The conference agreement follows the Senate amendment, effective for interviews conducted on or after 90 days after the date of enactment.

IRS explanation.—The conference agreement follows the Senate amendment, with technical clarification of the definition of interviews at which an explanation must be provided. In addition, the requirement of notification of referral to the Criminal Investigation Division is deleted. This provision is effective for interviews conducted on or after the 90th day after the date of enactment.

Taxpayer representatives.—The conference agreement follows the Senate amendment. It is the intent of the conferees that, in cases where the IRS notifies a taxpayer that the taxpayer's representative is responsible for unreasonable delay or hindrance, the IRS may continue to utilize current IRS Manual procedures relating to bypassing a taxpayer's representative. The provision is effective for interviews conducted on or after the 90th day after the date of enactment.

3. Taxpayers may rely on written advice of the Internal Revenue Service

Present Law

The IRS administratively may abate some penalties in a variety of circumstances.

House Bill

No provision.

Senate Amendment

The IRS is required to abate any portion of any penalty or addition to tax that is attributable to erroneous written advice furnished by the IRS to a taxpayer, where such advice was specifically requested in writing by the taxpayer and reasonably relied upon, unless the taxpayer failed to provide adequate or accurate information when requesting the advice. It is intended that this provision not be construed to require the IRS to provide written advice to taxpayers.

The provision is effective for advice requested on or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that the IRS must issue regulations within 180 days to implement this provision.

The conference agreement applies with respect to advice requested on or after January 1, 1989.

4. Taxpayer assistance orders

Present Law

The Taxpayer Ombudsman administers the IRS Problem Resolution Program, which is designed to resolve a wide range of tax administration problems that are not remedied through normal operating procedures or administrative channels. The Ombudsman may issue orders to affect immediate review of an IRS action. The authority of the Ombudsman, however, does not permit the Ombudsman to change a technical decision.

House Bill

No provision.

Senate Amendment

The Taxpayer Ombudsman (or any designee of the Ombudsman) is provided statutory authority to issue a taxpayer assistance order, if, in the determination of the Ombudsman, the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the IRS is administering the internal revenue laws. The Ombudsman may take action whether or not a taxpayer has filed an application requesting relief. A taxpayer assistance order may require remedial actions, such as release from levy of property of the taxpayer. A taxpayer assistance order is binding on the IRS unless modified or rescinded by the Ombudsman, a district director, or any superior of a district director.

Any applicable statute of limitations (e.g., the statute of limitation under sec. 6501 relating to the assessment or collection of tax) is suspended starting on the date that the taxpayer files an application for a taxpayer assistance order with the Ombudsman and ending on the date that the Ombudsman makes a decision on the taxpayer's application (or a later date if the Ombudsman's order resulting from a taxpayer's application provides for continued suspension of the statute of limitations). The statute of limitations is not suspended in cases where the Ombudsman issues an order in the absence of an application for relief by the taxpayer.

The IRS must issue regulations within 90 days of the date of enactment to implement this provision.

This provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that a taxpayer assistance order also may be modified or rescinded by a service center director, compliance center director, regional director of appeals, or a superior of such directors. The conferees also intend that a duly authorized taxpayer's representative may file an application on behalf of a taxpayer with the Ombudsman for a taxpayer assistance order.

The provision is effective on January 1, 1989.

5. Office of Inspector General

Present Law

The Treasury Department has a nonstatutory Inspector General with internal audit and investigative responsibilities for the Department, except for its four law enforcement agencies: IRS, Secret Service, Customs Service, and the Bureau of Alcohol, Tobacco, and Firearms. These functions are performed at the IRS by the Inspection Division, which reports directly to the IRS Commissioner.

On October 18, 1988, the President signed the Inspector General Act of 1988, P.L. 100-504, 102 Stat. 2515, which establishes a statutory Inspector General within the Treasury Department with oversight authority over all agencies within that Department. Under that Act, the Inspector General is given authority to oversee IRS' existing internal audit and investigative personnel and also to initiate independent internal audits of the IRS. That Act does not establish a separate statutory Inspector General for the IRS.

House Bill

No provision.

Senate Amendment

A statutory Inspector General is established within the IRS. In addition, a separate statutory Inspector General is established within the Treasury Department to provide general oversight over all other agencies within the Treasury Department. The IRS Inspector General is to be appointed by the President from a small pool of senior career personnel at the IRS with demonstrated ability in investigative techniques or internal audit functions. The Inspector General office for the IRS is to incorporate the existing IRS Inspection Division. The IRS Inspector General is not empowered to change determinations relating to a taxpayer's liability, and is to be under the direction and control of the IRS Commissioner with respect to matters requiring access to certain sensitive information, such as ongoing criminal investigations and deliberations on policy matters. If the Commissioner exercises the authority to prohibit an audit or investigation in order to prevent disclosure of sensitive information, the Commissioner must so notify the IRS Inspector General in writing and the IRS Inspector General must transmit a copy of the notice to appropriate committees of Congress.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement does not include this provision from the Senate amendment, in light of the enactment of the Inspector General Act of 1988. Disclosure of tax returns or return information to the Treasury Inspector General provided under the Inspection General Act of 1988 is under the same conditions and with the same restrictions and safeguard requirements as other disclosures under section 6103 of the Code.

6. Basis for evaluation of IRS employees

Present Law

The IRS Manual prohibits the use of production quotas or goals based upon sums collected to evaluate IRS enforcement officers, appeals officers, and reviewers.

House Bill

No provision.

Senate Amendment

The IRS is prohibited from using records of tax enforcement results to evaluate enforcement officers, appeals officers, and reviewers or to impose or suggest production quotas or goals. The IRS will not be treated as failing to meet the requirements of this provision if it uses these records in accordance with IRS Policy Statement P-1-20, as in effect upon enactment of this provision, provided that it does so in a manner that does not violate the general prohibition provided for by this provision. Each district director must certify quarterly that enforcement results are not being used in a prohibited manner.

This provision is effective for evaluations conducted on or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, except that the provision applies only to the evaluation of IRS employees directly involved in collection activities and their immediate supervisors.

The conference agreement applies to evaluations conducted on or after January 1, 1989.

7. Procedures relating to IRS regulations

Present Law

The IRS publishes all regulations in the Federal Register. Before final regulations are promulgated, proposed regulations are issued. Proposed regulations invite comments from the public and Government agencies. The IRS also issues some regulations as temporary regulations. Generally, temporary regulations are effective immediately upon publication and remain in effect until replaced by final regulations. When the IRS issues temporary regulations, it generally also issues those same regulations in proposed form by cross-reference.

House Bill

No provision.

Senate Amendment

The IRS is required to solicit comments from the Small Business Administration (SBA) after the publication of proposed regulations or before the promulgation of final regulations. The SBA is allowed four weeks after the receipt of the regulations to provide its comments on the impact of the regulations on small businesses.

In addition, each time the IRS issues temporary regulations, the IRS must simultaneously issue those regulations in proposed form. The IRS may continue its present practice of issuing proposed regulations by cross-reference at the time temporary regulations are issued. Temporary regulations are permitted to remain in effect for no more than two years after the date of their issuance. The expiration of temporary regulations at the end of this two-year period is not to affect the validity of those regulations during the two-year period.

This provision is effective for regulations issued after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that temporary regulations are permitted to remain in effect for no more than three years after the date of their issuance.

In most (but not all) instances, the IRS issues proposed regulations before it issues final regulations. The Senate amendment is clarified so that whenever the IRS follows its normal procedure of issuing proposed regulations before final regulations, it must solicit comments from the SBA after the publication of proposed regulations (rather than prior to the publication of final regulations). Only if the IRS issues final regulations directly (without the issuance of proposed regulations) is the IRS to solicit comments from the SBA prior to the promulgation of final regulations. The intent of this clarification is to provide the SBA its opportunity to comment at the same time the public is invited to comment in the notice of proposed regulations.

The conference agreement applies to regulations issued after the 10th day after the date of enactment.

8. Content of tax due and deficiency notices

Present Law

Although the IRS generally explains the basis of a tax deficiency in a statutory notice, the Code does not require the IRS to explain the basis for assessing penalties.

House Bill

No provision.

Senate Amendment

All tax due notices or deficiency notices must contain both a description of the basis for, and an identification of the amounts (if any) of, tax due, interest, additions to tax, and penalties. An inadequate description in a notice of deficiency or tax due shall not invalidate the notice. In addition, in the case of interest accruing with respect to amounts described in a notice of deficiency, it is sufficient if the notice states that interest at the legal rate is owing on the amount due.

The provision applies to mailings made after the date that is 180 days after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that the provision is limited to tax due or deficiency notices described in sections 6155, 6212, and 6303, notices generated out of information reporting matching programs, or the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals. It is the intent of the conferees that this information be included in the original notice sent by IRS; later copies of a particular notice sent to the same taxpayer need not contain this information if the IRS determines that including it would be confusing to taxpayers.

Although the provision is limited to the specified notices, the conferees expect the IRS to make every effort to improve the clarity of all notices and explanations that are sent to taxpayers. The conferees believe that all correspondence should be sufficiently clear to enable a taxpayer to understand an IRS question about a tax return as well as any adjustments or penalties applied to a tax return.

The conference agreement applies to mailings made on or after January 1, 1990. The IRS must report to Congress no later than July 1, 1989, on its progress in implementing this provision.

9. Installment payment of tax liability

Present Law

The IRS is not required to enter into installment payment agreements with taxpayers, but generally does so if a taxpayer who is unable to pay the delinquency in full is able to make payments on the delinquent taxes and pay current taxes as they become due. A change in the taxpayer's financial condition may result in modification of the installment payment agreement.

House Bill

No provision.

Senate Amendment

The IRS is granted statutory authority to enter into a written installment payment agreement if the IRS determines that an agreement will facilitate collection of the tax owed. The agreement is to remain in effect for the term of the agreement unless (1) the taxpayer provided inaccurate or incomplete information, (2) the taxpayer fails to pay an installment when due, (3) the taxpayer fails to pay any other tax liability when due, (4) the taxpayer fails to respond to any reasonable request by the IRS to supply updated financial information, or (5) the IRS determines that the collection of any tax to which an agreement relates is in jeopardy.

In addition, the IRS may alter, modify or terminate an installment payment agreement if the IRS determines that the financial condition of the taxpayer has significantly changed. This action may be taken only if the IRS notifies the taxpayer of the determination at least 30 days prior to the date of the action and provides the reason for such determination in the notification.

This provision is effective for installment agreements entered into after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

10. Assistant Commissioner for Taxpayer Services

Present Law

There is currently within the IRS an Assistant Commissioner (Taxpayer Services and Returns Processing). This position is not provided by statute.

House Bill

No provision.

Senate Amendment

The provision establishes statutorily an Assistant Commissioner for Taxpayer Services who shall be responsible for taxpayer services as designated by the Commissioner, such as telephone, walk-in, and taxpayer educational services, and the design and production of tax and informational forms. The Assistant Commissioner for Taxpayer Services, jointly with the Taxpayer Ombudsman, must annually report to the Congress concerning the quality of taxpayer services provided by the IRS.

This provision is effective on the 180th day after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

11. Levy and distraint

Present Law

Notice.—At least 10 days before collecting a tax by levy (i.e., seizure of the taxpayer's property) the IRS must provide the taxpayer written notice of its intent to levy. If the IRS finds that collection of tax is in jeopardy, it may collect the tax by levy without providing this notice or waiting 10 days.

Property subject to levy.—Property subject to levy includes any property (or rights to property being held by others) belonging to the taxpayer, except property specifically excluded from levy by law, which includes (1) fuel, provisions, furniture, and personal household effects, not exceeding $1,500 in aggregate value; and (2) books and tools necessary for the trade, business, or profession of the taxpayer, not exceeding $1,000 in aggregate value.

Levy on wages.—The IRS may instruct the taxpayer's employer to pay directly to the IRS amounts otherwise payable to the taxpayer as wages, except (1) so much of the wages of the taxpayer as is necessary to comply with a prior judgment of a court for support of any minor children of the taxpayer, and (2) a minimum amount of wages or other income (in general, $75 per week plus $25 per week for each dependent).

Release of levy.—The IRS has authority to release a levy if it determines that this will facilitate the collection of tax.

House Bill

No provision.

Senate Amendment

Notice.—The period from the date the IRS provides written notice to a taxpayer to the first permissible date of the collection of tax by levy is extended to 30 days. As under present law, the notice and waiting period requirements do not apply if the IRS finds that collection of the tax is in jeopardy. The notice preceding levy is required to contain a description of Code provisions and administrative procedures and appeals applicable to specific aspects of collection, as well as a description of the alternatives available to taxpayers that may prevent levy on taxpayers' property.

Property subject to levy.—The type of property exempt from levy is expanded in several respects. First, the $1,500 exemption from levy for fuel, provisions, furniture, and personal household effects is to be indexed for inflation in 1989 and 1990. Second, the $1,000 exemption from levy for books, tools, machinery, or equipment that are necessary for the trade, business, or profession of the taxpayer is also to be indexed for inflation in 1989 and 1990. Third, the provision exempts from levy a taxpayer's principal residence and tangible personal property essential to the taxpayer's trade or business, unless an IRS district director or assistant director personally approves the levy in writing or the collection of the tax is found to be in jeopardy. For this purpose, property is essential business property only if the business of the taxpayer cannot continue without it. Fourth, no levy may be made on property if the estimated expenses of levy and sale exceed the fair market value of the property.

The IRS is prohibited from levying on property of any person on any day on which the person is required to appear in response to a summons issued by the IRS, unless the IRS determines that the collection of tax is in jeopardy. In addition, banks and other financial institutions are required to hold accounts garnished by the IRS for 21 days after receiving the IRS notice of levy, in order to provide taxpayers an opportunity to notify the IRS of errors with respect to garnished accounts. Any interest accruing on the accounts during the 21-day period is to be surrendered to the IRS at the end of the 21-day period. The levy on any account may be released before the expiration of the 21-day period with the permission of the IRS.

Levy on wages.—The amount of wages exempt from levy for each week is increased to an amount equal to the taxpayer's standard deduction and personal exemptions allowable for the taxable year in which the levy occurs, divided by 52.

Release of levy.—The IRS must release a levy on property if (1) the liability for which the levy was made is satisfied, (2) the IRS determines that release will facilitate the collection of the liability, (3) an installment payment agreement has been executed with respect to such liability, (4) the IRS has determined that the levy is creating an economic hardship due to the taxpayer's financial condition, or (5) the fair market value of the property exceeds the liability and partial release would not hinder collection of the tax and related costs owed to the IRS. The release of a levy under this provision is not to prevent a subsequent levy on the same property.

The provision is effective for levies issued after the date that is 90 days after the date of enactment.

Conference Agreement

Notice.—The conference agreement follows the Senate amendment, except that the notice preceding the levy must be a brief statement in simple and nontechnical terms; the requirement that Code citations be included is deleted.

Property subject to levy.—The conference agreement generally follows the Senate amendment, with several modifications. First, the $1,500 exemption from levy for fuel, provisions, furniture, and personal household effects is increased to $1,550 for 1989 and to $1,650 for 1990 and years thereafter. Second, the $1,000 exemption from levy for books, tools, machinery, or equipment that are necessary for the trade, business, or profession of the taxpayer is increased to $1,050 for 1989 and to $1,100 for 1990 and years thereafter. Third, the conference agreement deletes the provision that exempts from levy (unless certain conditions are met) tangible personal property essential to the taxpayer's trade or business. Instead, the conference agreement provides that, in cases where tangible personal property essential to a taxpayer's trade or business is levied upon by the IRS, an accelerated appeals process must be provided by the IRS in order to determine whether the levy should be released due to any of the statutory grounds that govern release of levy (e.g., the IRS determines that release of such levy will facilitate the collection of tax, the IRS determines that such levy is creating an economic hardship due to the financial condition of the taxpayer, or the fair market value of the property exceeds such liability and release of the levy on a part of such property could be made without hindering the collection of such liability). Fourth, the conference agreement exempts from levy certain AFDC, SSI, State and local welfare, and JTPA benefits.

Levy on wages.—The conference agreement follows the Senate amendment, modified so that if the taxpayer does not supply the IRS with sufficient information to enable the IRS to determine the proper standard deduction or number of exemptions of the taxpayer, the amount of wages exempt from levy is the standard deduction for a married individual filing separately plus one personal exemption, divided by 52.

Release of levy.—The conference agreement follows the Senate amendment, with the addition of a provision permitting the taxpayer to request that the IRS sell levied property.

The conference agreement applies to levies issued on or after July 1, 1989. The provision permitting a taxpayer to request that the IRS sell levied property applies to requests made on or after January 1, 1989.

12. Review of jeopardy levy and assessment procedures

Present Law

Assessment of a tax (i.e., recording of the tax liability in the office of the District Director) is the final act by the IRS that establishes the liability of a taxpayer for a tax. After assessment, the IRS will attempt to collect the tax. The Code authorizes the IRS to make a jeopardy assessment (i.e., to immediately assess and demand payment of a tax and any penalties and interest) where collection would be endangered if regular procedures are followed. Furthermore, if the IRS determines that collection of tax would be jeopardized by waiting the regular 10-day period after notice and demand for payment have been provided to the taxpayer, the IRS can collect the tax by jeopardy levy (i.e., immediately seize certain of the taxpayer's property). The Code provides special rules relating to administrative review and judicial review (by Federal district courts) of jeopardy assessments. These rules do not apply to jeopardy levies.

House Bill

No provision.

Senate Amendment

The existing rules relating to the review of jeopardy assessments are extended to the review of jeopardy levies. The Tax Court is provided jurisdiction concurrent with Federal district courts with respect to challenges to a jeopardy assessment or jeopardy levy if the taxpayer has filed a petition with the Tax Court prior to the making of the assessment or levy with respect to any deficiency covered by the jeopardy assessment or jeopardy levy notice. In all other cases, the appropriate district court continues to have exclusive jurisdiction over such an action.

The provision applies to jeopardy levies issued and jeopardy assessments made after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, effective for jeopardy levies issued and jeopardy assessments made on or after July 1, 1989.

13. Administrative appeal of liens

Present Law

A taxpayer can obtain a review within the IRS of an initial determination of tax deficiency before the matter proceeds to collection. There is no statutory procedure for the administrative appeal of IRS decisions concerning the collection of a tax liability.

House Bill

No provision.

Senate Amendment

The IRS is required to promulgate regulations within 180 days after enactment that provide taxpayers with an administrative procedure to obtain review of the filing of a notice of lien in the public record and an opportunity to petition for the release of such lien. This administrative procedure is intended to be used to correct erroneous filings and not to challenge the underlying deficiency leading to the imposition of a lien.

If the IRS determines that filing of a notice of lien was erroneous (i.e., the tax liability that gave rise to the lien had been satisfied or the liability had been assessed in violation of the restrictions on assessment in section 6213 pertaining to deficiency assessments or in Title 11), the IRS is required to issue immediately a certificate of release of the lien and include in the certificate a statement that the filing of the lien was erroneous. This ensures that the public record contains a statement that the filing of the notice of the lien was not attributable to the taxpayer's fault, which will facilitate repair of the taxpayer's credit and other financial records. This certificate of release of an erroneous lien must be issued whether or not the lien was challenged in an administrative review procedure.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement generally follows the Senate amendment. The IRS must issue a certificate of release of lien expeditiously (and, to the extent practicable, within 14 days) after determining that the filing of the notice of lien was erroneous. The provision is effective 60 days after the issuance of the mandated regulations.

14. Awarding of costs and certain fees in administrative and civil actions

Present Law

Reasonable costs.—A taxpayer who is a "prevailing party" in a tax case in any Federal court may be awarded reasonable litigation costs if the position of the United States was not substantially justified. Reasonable litigation costs include attorneys fees (generally limited to $75 per hour), expenses of expert witnesses, and court costs. Costs incurred during the IRS administrative process generally are not recoverable.

Burden of proof.—To be awarded reasonable litigation costs, the taxpayer must establish that the position of the United States in the case was not substantially justified. In addition, the person must substantially prevail with respect to the amount in controversy or the most significant issue(s) in the case.

Position of the United States.—In determining whether the position of the United States was substantially justified, the position of the United States is determined beginning with the position in the civil proceeding, or, if applicable, the position taken by the IRS district counsel administratively. This generally does not include positions taken in the audit or appeals processes.

Administrative settlement of claims for litigation costs.—The Code does not provide explicit authority to the IRS to settle administratively claims for litigation costs prior to the commencement of the civil action.

House Bill

No provision.

Senate Amendment

Recoverable costs.—Any person who substantially prevails in any action brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding.

For this purpose, reasonable litigation costs are defined as under current law, while reasonable administrative costs include (1) any administrative fees or similar charges imposed by the IRS, (2) reasonable expenses of expert witnesses, (3) the reasonable cost of any study, analysis, engineering report, test or project that is necessary for the preparation of the person's case, and (4) reasonable fees (generally not to exceed $75 per hour) paid or incurred for the services of a qualified representative of the taxpayer in connection with the administrative action, but only if such administrative costs are incurred after the earlier of (1) the date of the first notice of proposed deficiency (generally the 30-day letter) that allows the person an opportunity for administrative review in the IRS Office of Appeals, or (2) the date of the notice of deficiency described in section 6212 of the Code.

As under present law, a judgment for reasonable litigation costs shall not be awarded by a court unless the taxpayer has exhausted administrative remedies.

Burden of proof.—The burden of proof with respect to whether the position of the United States was substantially justified is shifted to the Government, so that if a taxpayer substantially prevails with respect to the amount in controversy or the most significant issue(s) in the case, the Government then must establish that its position was substantially justified in order to prevent the taxpayer from recovering costs.

Position of the United States.—In determining whether the position of the United States was substantially justified, the position of the United States is determined as of the later of (1) the date of the first letter of proposed deficiency (generally the 30-day letter) that allows the taxpayer an opportunity for administrative review in the IRS Appeals Office (or, if no letter of proposed deficiency is sent, the date of the notice of deficiency described in section 6212 of the Code), or (2) the date by which the relevant evidence under the control of the taxpayer, as well as relevant legal arguments, with respect to such action have been presented by the taxpayer to IRS examination or Service Center personnel.

Thus, in the case of a computer-generated underreporter notice (i.e., a Form CP-2000), the position of the United States generally is determined only after the taxpayer has provided the IRS with sufficient information to enable a reasonable person to determine whether the notice should have been issued. For example, if the computer-generated notice proposes a deficiency due to the failure to report interest income shown on a Form 1099-INT filed by a third party, the position of the United States is not to be determined until after the taxpayer provides sufficient information to establish whether the interest should have been reported on the tax return of the taxpayer who received the deficiency notice.

Administrative settlement of claims for administrative costs and litigation costs.—The IRS is provided with the authority to settle claims for administrative costs and litigation costs. A decision by the IRS granting or denying an award of costs is appealable to the Tax Court under the small case procedures.

The provision applies to actions commenced after the date of enactment.

Conference Agreement

Recoverable costs.—The conference agreement follows the Senate amendment, with the modification that recoverable costs include only reasonable litigation costs plus reasonable administrative costs incurred after the earlier of (1) the date of the receipt by the taxpayer of the notice of the decision of the IRS Office of Appeals, or (2) the date of the notice of deficiency. Thus, with respect to a collection action, only reasonable litigation costs are recoverable under this provision.

Burden of proof.—The conference agreement retains present law.

Position of the United States.—The conference agreement follows the Senate amendment, with the modification that the position of the United States is determined as of the earlier of (1) the date of the receipt by the taxpayer of the notice of the decision of the IRS Office of Appeals, or (2) the date of the notice of deficiency. If neither is applicable, the position of the United States is that taken in the litigation.

Administrative settlement of claims for administrative costs and litigation costs.—The conference agreement follows the Senate amendment.

The conference agreement applies to proceedings commencing after the date of enactment.

15. Civil cause of action for damages sustained due to failure to release lien

Present Law

The Code does not grant taxpayers a right to bring an action for damages resulting from the wrongful failure to remove a lien on a taxpayer's property.

House Bill

No provision.

Senate Amendment

Taxpayers are provided with the right to sue the Federal Government in Federal district court or Tax Court if any IRS employee knowingly or negligently fails to release a lien on the taxpayer's property as required under the Code. Taxpayers may recover the costs of the action and damages equal to the greater of (1) the actual direct economic damages sustained by the taxpayer which, but for the actions of the IRS, would not have been sustained, or (2) $100 per day (up to $1000) for each day the failure continues during the period that begins ten days after the taxpayer provides written notice to the IRS of the failure to release the lien. This written notice must be provided by the taxpayer after the conclusion of the 30-day period during which the IRS is required to release the lien. The IRS is authorized to establish reasonable requirements concerning the form and manner of the written notice. The committee anticipates that the requirements imposed by the IRS with respect to the written notice will require only information concerning the name and taxpayer identification number of the taxpayer, information concerning the type and location of the property subject to the lien, and any information that is necessary to establish that the lien should be released.

The IRS has authority to settle administratively claims under this provision. A judgment for damages under this provision may not be awarded by a court unless the taxpayer has exhausted administrative remedies. In addition, the actual economic damages recoverable by a taxpayer are to be reduced to the extent that the damages could reasonably have been mitigated by the taxpayer. Taxpayers have two years after discovery of an erroneous failure by the IRS to release a lien in which to bring an action under this provision.

This provision applies to taxpayer notices provided and damages arising after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with several modifications. First, an action under this provision may be brought only in Federal district court and not in the Tax Court. Second, recovery under the provision is limited to actual, direct economic damages sustained by the taxpayer which, but for the actions of the IRS, would not have been sustained, plus the costs of the action. Third, the Treasury Department must issue regulations that prescribe reasonable procedures for a taxpayer to notify the IRS of the failure to release a lien. Fourth, a taxpayer's claim under this provision is barred unless the action is commenced within two years after the date the right of action accrues.[1] Fifth, the conference agreement deletes the specific authority granted the IRS to settle administratively claims under this provision. However, it is the intent of the conferees that the general settlement authority of the IRS provided under Code section 7122 be utilized, where appropriate, to settle actions brought under this provision.

The conference agreement applies to taxpayer notices provided and damages arising after December 31, 1988.

16. Civil cause of action for damages sustained due to certain unauthorized actions by IRS

Present Law

Taxpayers do not have a specific right to bring an action against the Government for damages sustained due to unreasonable actions taken by an IRS employee.

House Bill

No provision.

Senate Amendment

Taxpayers are granted the right to sue the Federal Government in Federal district court or Tax Court for damages if in connection with the determination or collection of any Federal tax, an IRS employee carelessly, recklessly, or intentionally disregards any provision of Federal law or any regulation promulgated under the Internal Revenue Code. The taxpayer may recover the costs of the action plus actual direct economic damages sustained by the taxpayer as a proximate result of the unlawful actions or inaction of the IRS employee.

A taxpayer may not recover under this provision if the taxpayer was contributorily negligent. In addition, the damages recoverable under this provision are to be reduced to the extent that the damages could reasonably have been mitigated by the taxpayer.

The IRS has authority to settle administratively claims under this provision. A judgment for damages under this provision may not be awarded by a court unless the taxpayer has exhausted administrative remedies. A taxpayer's claim under this provision is barred unless the action is commenced within two years after the discovery by the taxpayer of the improper IRS action. If the Tax Court or district court determines that the taxpayer's lawsuit is frivolous or groundless, the court may impose a penalty on the taxpayer of up to $10,000.

The provision applies to actions of IRS officers or employees that occur after the date of enactment.

---

[1] The conferees intend that the general accrual rule applied under the Federal Tort Claims Act (28 U.S.C. sec. 2401(b)) be applied to actions under this provision; that is, the right of action does not accrue until a claimant has had a reasonable opportunity to discover all the essential elements of a possible cause of action. *See, e.g., Rosales v. United States*, 824 F.2d 799 (9th Cir. 1987); *Zeidler v. United States*, 601 F.2d 527 (10th Cir. 1979).

Conference Agreement

The conference agreement follows the Senate amendment, with several modifications. First, the right to sue authorized by the provision is limited to allegations of reckless or intentional disregard by an IRS employee. An action may not be brought under this provision alleging mere negligence or carelessness on the part of an IRS employee. Second, the provision is limited to reckless or intentional disregard in connection with the collection of tax. An action under this provision may not be based on alleged reckless or intentional disregard in connection with the determination of tax. Third, the provision is limited to reckless or intentional disregard of the Internal Revenue Code and the regulations thereunder. An action may not be brought under this provision based on an alleged violation of a Federal law other than the Internal Revenue Code or a regulation promulgated thereunder. Fourth, the conference agreement deletes the provision barring a taxpayer from any recovery if the taxpayer was contributorily negligent.[2] Fifth, the total of actual damages plus the costs of the action recoverable under this provision may not exceed $100,000. Sixth, an action under this provision may be brought only in Federal district court and not in the Tax Court. Seventh, except as provided by new Code section 7432, an action brought under this provision shall be the exclusive remedy for recovering damages resulting from reckless or intentional disregard of a provision of the Internal Revenue Code, or a regulation promulgated thereunder, by an IRS employee engaged in the collection of any Federal tax. Eighth, a taxpayer's claim under this provision is barred unless the action is commenced within two years after the date the right of action accrues.[3] Ninth, the conference agreement deletes the specific authority granted the IRS to settle administratively claims under this provision. However, it is the intent of the conferees that the general settlement authority of the IRS provided under Code section 7122 be utilized, where appropriate, to settle actions brought under this provision.

The conference agreement applies to actions taken by IRS employees after the date of enactment.

17. Assessable penalty for improper disclosure or use of information by preparers of returns

Present Law

The Code provides that a tax return preparer is subject to a criminal penalty of a $1,000 fine, or one year in prison, or both, if the preparer discloses any information furnished to him or her in connection with the preparation of an income tax return, or uses any such information for any purpose other than to prepare the return (Code section 7216). The Code does not provide for a civil penalty in cases where a return preparer improperly discloses or uses such information.

---

[2] However, the amount of damages awarded under the provision shall be reduced by the amount of such damages which could have reasonably been mitigated by the taxpayer.

[3] The conferees intend that the general accrual rule applied under the Federal Tort Claims Act (28 U.S.C. sec. 2401(b)) be applied to actions under this provision; that is, the right of action does not accrue until a claimant has had a reasonable opportunity to discover all the essential elements of a possible cause of action. *See, e.g., Rosales v. United States*, 824 F.2d 799 (9th Cir. 1987); *Zeidler v. United States*, 601 F.2d 527 (10th Cir. 1979).

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement provides that if a tax return preparer discloses any information furnished to him or her in connection with the preparation of an income tax return, or uses such information for any purpose other than to prepare the return, then the preparer shall be subject to a civil penalty of $250 for each such disclosure or use, up to a maximum of $10,000 per calendar year. The penalty shall not be imposed if disclosure or use of return information was made pursuant to a court order or one of the present-law provisions of the Internal Revenue Code that permit disclosure under specified circumstances. In addition, the conference agreement modifies the present-law criminal penalty imposed upon return preparers who improperly disclose or use information furnished to them in connection with the preparation of an income tax return so that the criminal penalty applies only where the return preparer knowingly or recklessly disclosed or used such information.

The conference agreement applies to disclosures or uses after December 31, 1988.

18. Jurisdiction to restrain certain premature assessments

Present Law

Jurisdiction to restrain IRS assessment and collection of tax rests solely with the Federal district courts. Consequently, even though as a general rule no assessment or collection of tax may be made until the decision of the Tax Court has become final, a taxpayer with a case before the Tax Court who is faced with a premature IRS assessment is forced to challenge that assessment in Federal district court.

House Bill

No provision.

Senate Amendment

The Tax Court is granted jurisdiction (concurrent with Federal district courts) to restrain the assessment and collection of any tax by the IRS if the tax is the subject of a timely filed petition pending before the Tax Court.

The provision applies to orders entered after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

19. Jurisdiction to enforce overpayment determinations

Present Law

The Tax Court has jurisdiction to determine that a taxpayer is due a refund of a tax for which the IRS has asserted a deficiency. However, if the IRS fails to refund or credit an overpayment determined by the Tax Court, the taxpayer must seek relief in another court.

House Bill

No provision.

Senate Amendment

The Tax Court is granted jurisdiction to order the refund of an overpayment plus interest if, within 120 days after a Tax Court decision has become final, the IRS fails to refund to a taxpayer an overpayment determined by the Tax Court. If the IRS does not establish that its failure to refund an overpayment was substantially justified, then the taxpayer is entitled to interest on the overpayment at 120 percent of the overpayment interest rate.

The provision applies to overpayments determined by the Tax Court which have not been refunded by the 90th day after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, except that the provision entitling the taxpayer to a higher rate of interest in certain circumstances is deleted.

20. Jurisdiction to review certain sales of seized property

Present Law

If a taxpayer fails to pay a tax on notice and demand after the IRS makes a jeopardy assessment, a lien arises in favor of the United States upon property belonging to the taxpayer and the IRS can immediately seize the taxpayer's property. Pending issuance of a notice of deficiency, and, if the taxpayer challenges the assessment in either the Tax Court or Federal district court, pending the decision of such court, the IRS cannot sell property seized pursuant to a jeopardy assessment, unless (1) the taxpayer consents to the sale, (2) the IRS determines that the expenses of conservation and maintenance will greatly reduce the net proceeds, or (3) the property is liable to perish or become greatly reduced in value by keeping, or cannot be kept without great expense. If the taxpayer wishes to contest an IRS determination to sell seized property, the only recourse is to bring suit in Federal district court.

House Bill

No provision.

Senate Amendment

The Tax Court is granted jurisdiction during the pendency of proceedings before it to review the IRS' determination to sell seized property under one of the present-law exceptions to the stay of sale.

The provision is effective on the 90th day after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

21. Jurisdiction to redetermine interest on deficiencies

Present Law

Following a decision by the Tax Court, the IRS assesses the entire amount redetermined as the deficiency by the Tax Court and adds to the deficiency interest computed at the statutory rate. If the taxpayer disagrees with the IRS' interest computation, however, the Tax Court does not have jurisdiction to resolve that dispute.

House Bill

No provision.

Senate Amendment

If a dispute arises over the IRS' computation of the interest due on a deficiency, then within one year from the date the Tax Court decision becomes final the taxpayer may move to reopen the Tax Court proceeding for a determination of interest due. The taxpayer is required to pay the entire deficiency redetermined by the Tax Court and the interest determined by the IRS before challenging the IRS' computation of interest in the Tax Court.

The provision applies to assessments of deficiencies made after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

22. Jurisdiction to modify decisions in certain estate tax cases

Present Law

The Code allows a deduction against either the estate tax or the income tax for interest paid by an estate on a Federal or State estate tax liability during the period the estate is being administered. In addition, the Code allows certain estates which consist largely of an interest in a closely held business to elect to pay Federal estate tax over an extended-payment period. The IRS has taken the position that, because an estate may accelerate the payment of Federal or State estate taxes during an extended-payment period, an estate is not entitled to a deduction for interest anticipated to be paid during the extended-payment period but is entitled to a deduction only when such interest is actually paid by the estate. Consequently, because the amount of the estate tax deduction for interest to which an estate is entitled cannot be determined until the interest is paid, the Tax Court may not enter a final judgment in an estate tax case until the extended-payment period has expired.

House Bill

No provision.

Senate Amendment

The Tax Court is granted authority to modify a final decision in an estate tax case solely to reflect the estate's entitlement to a deduction for interest paid during an extended-payment period on the Federal or State estate tax liability. Thus, the Tax Court may enter a final decision in an estate tax case in which an extended-payment period is elected and subsequently, if necessary, modify the decision at the end of the extended-payment period to reflect interest actually paid by the estate. The Tax Court has discretion to hold a hearing on this matter at the end of the extended-payment period.

The provision applies to Tax Court cases for which the decision is not final on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

23. Refund jurisdiction for the Tax Court

Present Law

When a taxpayer receives notice from the IRS that it has determined a deficiency of tax, the taxpayer may, before paying the determined liability, petition the Tax Court for a redetermination of the deficiency within 90 days after the notice of deficiency was mailed. Alternatively, the taxpayer may pay the deficiency and file a claim for refund of the disputed amount with the IRS. If the IRS rejects the refund claim, or does not act within six months, then the taxpayer may bring an action for refund in Federal district court or the United States Claims Court, but not the Tax Court.

A taxpayer may also file with the IRS a claim for refund of an overpayment not attributable to a deficiency, and if the refund claim is rejected by the IRS, then the taxpayer may bring an action in Federal district court or the United States Claims Court seeking a refund of the asserted overpayment. The Tax Court has no jurisdiction to determine whether a taxpayer has made an overpayment except in the context of a deficiency proceeding.

House Bill

No provision.

Senate Amendment

The Tax Court is granted jurisdiction over tax refund actions against the IRS where there is already pending and awaiting submission for disposition by a judge a deficiency action in the Tax Court, and where the issue in the refund action is related by subject matter to the deficiency action or the result in either of the two actions will affect the amount in controversy in the related action. All proceedings in the Tax Court would be stayed for 180 days if a refund action is filed in the Tax Court and there is a showing by the IRS that there has been no audit of the taxpayer's return for the period or type of tax involved in the refund action. The general prerequisites governing the commencement of tax refund actions would apply to refund actions filed in the Tax Court. A taxpayer would continue to ~~have the~~ option of filing a claim for refund in the appropriate Federal district court or the United States Claims Court.

The provision would apply to proceedings commenced in the Tax Court six months after enactment.

Conference Agreement

The conference agreement follows the House bill (i.e., does not include the Senate amendment).

K. Other Administrative Provisions

1. Tip reporting

Present Law

Under present law, employers are required, under certain circumstances, to provide an information report of an allocation of tips in large food or beverage establishments (defined generally to include those establishments that normally employ more than 10 employees). Under this provision, if tipped employees of large food or beverage establishments report tips aggregating 8 percent or more of the gross receipts of the establishment, then no reporting of a tip allocation is required. However, if this 8-percent reporting threshold is not met, the employer must allocate (as tips for information reporting purposes) an amount equal to the difference between 8 percent of gross receipts and the aggregate amount reported by employees. This allocation may be made pursuant to an agreement between the employer and ~~employees~~ or, in the absence of such an agreement, according to Treasury regulations.

These Treasury regulations provide that this allocation may be made by the employer in either of two ways. One is to allocate based on the portion of the gross receipts of the establishment attributable to the employee during a payroll period. The second is to allocate based on the portion of the total number of hours worked in the establishment attributable to the employee during a payroll period.

The method of tip allocation based on the number of hours worked may be utilized only by an establishment that employs less than the equivalent of 25 full-time employees during a payroll period. Establishments employing the equivalent of 25 or more full-time employees consequently have to use the portion of gross receipts method to allocate tips during the payroll period (absent an agreement between the employer and employees).

House Bill

The committee expressed its concern that a number of sizeable establishments may not be observing this law and encouraged them to do so.

Senate Amendment

No provision.

Conference Report

The conference agreement follows the House bill.

2. Disclosure of return information to certain cities

Present Law

Section 6103 provides for the confidentiality of returns and return information of taxpayers. The conditions under which returns and return information can be disclosed are specifically enumerated in that section. Disclosure of returns and return information to local income tax administrators generally is not permitted. However, a specific exception to this rule provides that any city with a population in excess of 2 million that imposes an income (or wage) tax may, if the Secretary in his sole discretion enters into an agreement with that city, receive returns and return information for the purposes for which States may obtain information, subject to the same safeguards as apply to States.

Cities that receive information must reimburse the Internal Revenue Service for its costs in the same manner as a State must under present law. Population is determined on the basis of the most recent decennial United States census data available.

House Bill

The House bill modifies section 6103(b)(5) so that the Secretary, in his sole discretion, may enter into an agreement to disclose returns and return information to local tax administrators in cities with populations in excess of 250,000 (rather than the present-law requirement of a population in excess of 2 million) that impose a tax on income or wages. The various safeguards and conditions governing disclosure of returns and return information to local tax administrators would remain unchanged. Moreover, unauthorized disclosure of returns or return information by an employee of a local agency receiving this information would continue to subject the employee to fine and imprisonment as provided by section 7213 and to the civil action provided by section 7431.

The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Provisions relating to previously required studies

Present Law

Present law requires the Treasury to prepare and submit to Congress many one-time and periodic studies on specific tax issues. Treasury is required to prepare reports on possessions corporations and on foreign sales corporations concerning every second tax year.

House Bill

The House bill deletes the requirement that Treasury prepare studies of the payment-in-kind program, the foreign oil and gas tax credit provisions, and the accounting methods of inventory. The bill also modifies the timing for reports on possessions corporations and foreign sales corporations so that studies would be prepared concerning tax returns of every fourth tax year.

This provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with the modification that studies of possessions corporations and foreign sales corporations would be prepared and reported to the Congress every fourth year using the most recently available information.

4. Treasury authority to prescribe class lives

Present Law

Depreciation recovery periods, for purposes of the modified accelerated cost recovery system, are generally determined by reference to the ADR class life of the asset. Certain assets are assigned recovery periods directly by statute.

An office in the Treasury Department monitors and analyzes the actual experience of depreciable assets and reports the findings to the Secretary. The Treasury Department generally has the authority to establish or change the class lives of depreciable assets. The depreciable life of certain assets may not be lengthened for property placed in service before January 1, 1992.

House Bill

No provision.

Senate Amendment

The Secretary's authority to lengthen the depreciable life of an asset, including assigned property, is revoked. The Treasury is expected to continue to study the actual experience of depreciable assets and report to the Congress on its findings.

The provision is effective on date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with a modification expanding the prohibition on Treasury authority to include actions that shorten class lives of assets (including assigned property). The conferees wish to clarify that the prohibition on Treasury authority to shorten or lengthen depreciable lives extends to assets which do not have class lives. The conferees expect Treasury to continue to study the experience of assets and report its findings to Congress.

5. Repeal of reporting requirements for windfall profit tax

Present Law

The crude oil windfall profit tax was repealed for oil removed on or after August 23, 1988 (P.L. 100-418). On October 11, 1988, the Internal Revenue Service issued Notice 88-115 providing that the annual information return of windfall profit tax is waived with respect to crude oil removed (or deemed removed) on or after January 1, 1988, if certain conditions are met.

House Bill

No provision.

Senate Amendment

The Senate amendment repeals the reporting requirements for crude oil removed after December 31, 1987, for which no windfall profit tax is due or withheld.

Conference Agreement

The conference agreement follows the Senate amendment.

The conferees clarify that the reporting requirements are repealed with respect to crude oil removed (or deemed removed) from the premises on or after January 1, 1988, which meets the following conditions: (1) the person otherwise required to furnish or file an information return for calendar year 1988 must reasonably believe that no windfall profit tax accrued during 1988 with respect to such crude oil (disregarding the net income limitation under section 4988(b) of the Code); and (2) there must have been no windfall profit tax withholding with respect to such crude oil.

L. Corporate/Personal Holding Company Provisions

1. Authority to pay refunds to fiduciary of insolvent member of affiliated groups

Present Law

Treasury regulations generally require a refund attributable to losses of any member of an affiliated group filing a consolidated return to be paid by the Internal Revenue Service to the parent corporation.

House Bill

Under the House bill, the Secretary of the Treasury is authorized to provide access to tax refunds to a statutory or court appointed fiduciary of an insolvent member of a group of corporations filing a consolidated tax return, to the extent the Secretary determines that the refund is properly attributable to the losses of such insolvent member and that such access is consistent with the purposes of the consolidated return provisions.

The provision is effective for pending or future statutory or court appointed fiduciary situations, in accordance with Treasury regulations.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

The conferees clarify that payment of any refund to a fiduciary under any regulations issued by the Secretary shall be deemed to be payment to all other members of the affiliated group for all purposes (including any administrative or court proceedings relating to the allowability of the refund) and shall satisfy any responsibility of the Secretary to make such payments to any member.

In addition, the conferees clarify that the Secretary is authorized to accept as valid a return filed by the statutory or court appointed fiduciary to the extent, if any, the Secretary determines is appropriate, and not inconsistent with the purposes of the consolidated return provisions.

2. Certain ownership changes not counted during bankruptcy

Present Law

Net operating loss limitations of the Tax Reform Act of 1986 do not apply to an ownership change resulting from certain bankruptcy reorganizations or proceedings if a petition in the case was filed with a court before August 14, 1986. When stock of a corporation is acquired during the pendency of a bankruptcy, an ownership change may occur and losses may be limited.

House Bill

No provision.

Senate Amendment

Under regulations to be prescribed by the Treasury, if any stock that was acquired by shareholders during a bankruptcy proceeding in a transaction that triggered an ownership change does not represent more than 50 percent of the value of the corporation (based on the value of the stock immediately after the completion of the bankruptcy proceeding), an amended return can generally be filed with respect to prior years for which losses were limited (without regard to otherwise applicable statute of limitations). This provision will apply only in the case of petitions in bankruptcy filed before August 14, 1986.

The provision is effective as if included in the 1986 Act.

Conference Agreement

The conference agreement follows the Senate amendment.

3. Application of Code sec. 7503 for purposes of Woods Investment Co. effective date

Present Law

Where the last day required by the tax laws to perform an act is a Saturday, Sunday or legal holiday, the act will be considered timely if it is performed on the next day that is not a Saturday, Sunday or legal holiday. It is not clear whether or to what extent this provision applies to the requirement that the disposition required for transition relief from the provision in the Revenue Act of 1987 which reverses the result in *Woods Investment Co.* must occur prior to January 1, 1989.

House Bill

Under the House bill, for purposes of transition relief from the provision which reverses the result in *Woods Investment Co.*, a disposition is treated as if it occurred on December 31, 1988, if it occurs on the next day following December 31, 1988, that is not a Saturday, Sunday or legal holiday.

The provision is effective as if included in the 1987 Act.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

4. Application of rules on personal holding company income to broker-dealers

Present Law

Personal holding company income of a broker-dealer includes interest income.

House Bill

No provision.

Senate Amendment

The definition of personal holding company income is modified to exclude interest received by broker-dealers with respect to: (1) any securities or money market instruments held as inventory; (2)

margin accounts; or (3) any financing for a customer secured by securities or money market instruments.

The provision is effective with respect to interest received after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Elimination of dividends received from banks from personal holding company income of bank holding companies

Present Law

Personal holding company income of a bank holding company includes dividends paid by subsidiary banks, unless the bank holding company owns 80 percent or more of the stock of the subsidiary bank.

House Bill

The definition of personal holding company income of a personal holding company which is a bank holding company is modified to exclude up to $3 million per year of dividends received from a bank if (1) the bank holding company owns at least 25 percent of the bank's stock and (2) the value of the stock in such banks has a value equal to 80 percent or more of the total value of the assets of the holding company.

The provision is effective with respect to dividends received by a bank holding company in its taxable years ending in 1989 and 1990.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

6. Substantiation of certain charitable contributions of inventory property by corporations

Present Law

Under section 155 of the Tax Reform Act of 1984, individuals, closely held corporations, and personal service corporations generally must obtain qualified appraisals meeting specified requirements in order to claim a charitable deduction exceeding $5,000 for certain contributions of property. (In the case of S corporations, the qualified appraisal requirements apply where the corporation claims such a charitable deduction.) The IRS recently announced that less stringent appraisal requirements would apply to charitable donations by certain corporations of inventory property to be used for care of the ill, the needy, or infants, such as contributions of food by a food retailer (if a C corporation) to tax-exempt organizations aiding the homeless (IR-88-137).

House Bill

No provision.

Senate Amendment

The Treasury Department is authorized to prescribe regulations allowing corporations (other than S corporations) to provide, in the case of charitable contributions described in Code section 170(e)(3)(A) of inventory property (sec. 1221(1)), less detailed substantiation than that required under the present-law qualified appraisal rule. For example, the regulations could require the donor corporation to furnish summary information about the donated inventory with its tax return, such as a description of the contributed items and the valuation method used. This provision authorizes waiver only of the 1984 Act qualified appraisal requirement, and does not modify the general statutory rule (sec. 170(a)(1)) that a charitable contribution is deductible only if verified in the manner required by Treasury regulations.

A contribution is described in section 170(e)(3)(A) if (1) it is made by a corporation (other than an S corporation) to a tax-exempt organization described in section 501(c)(3), other than to a private nonoperating foundation; (2) the property is to be used by the donee solely for the care of the ill, the needy, or infants, and such use is related to the donee's exempt function; (3) the property is not transferred by the donee in exchange for money, other property, or services; (4) the donor receives from the donee a written statement representing that the use and disposition of the property will be in accordance with conditions (2) and (3); and (5) if the donated property is subject to regulation under the Federal Food, Drug, and Cosmetic Act, the property fully satisfies the requirements of that Act.

This provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Relief from recognition of corporate level gain involving transfer of residential cooperative units

Present Law

Gain is recognized by the distributing corporation if appreciated property is distributed to shareholders in a liquidating or nonliquidating distribution. Shareholders who receive appreciated property in such a distribution in exchange for their stock generally recognize gain to the extent that the value of the property distributed exceeds their bases in the corporation's stock.

Section 1034 of the Code permits the deferral of gain if the taxpayer recognizes gain on the sale of his principal residence and acquires another principal residence within a 2-year period. For purposes of that section, stock held by a tenant-stockholder in a cooperative housing corporation is included in the definition of a principal residence if the shareholder used the house or apartment that he was entitled to occupy as such shareholder as his principal residence.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, except as provided in regulations, no gain or loss is recognized to a residential housing cooperative when property that qualifies as a principal residence is distributed to a tenant-stockholder in exchange for the tenant-stockholder's stock, to the extent the exchange qualifies for nonrecognition at the shareholder level under section 1034 of the Code.

It is expected that the Treasury Department will prescribe regulations providing reporting or other procedures to assure that the intended relief is provided only in cases where the house or apartment is in fact used by the taxpayer as his principal residence both before and after the distribution. Also, the Treasury Department may prescribe rules to assure that there is a full recapture of tax benefits (if any) that may have been claimed at the corporate level, to the extent the same benefits could not have been claimed by the shareholder if he had owned the house or apartment directly and used it as his principal residence.

The provision is effective as if included in the Tax Reform Act of 1986.

Conference Agreement

The conference agreement follows the Senate amendment.

8. Definition of ESOP eligible for relief from net operating loss limitations

Present law

Generally, if there is a more than 50% change in the ownership of a corporation that has net operating losses (old loss corporation), the use of the corporation's pre-change losses and credits is limited following that ownership change. Employer stock acquired by certain employee stock ownership plans (ESOPs) does not count in determining whether an ownership change has occured. An ESOP need only cover employees of a company that is a member of the same controlled group as the loss company in order for the acquisition of the stock of the loss company not to count in determining whether an ownership change has occurred.

House Bill

No provision.

Senate Bill

No provision.

Conference Agreement

The ESOP exception for purposes of the net operating loss and credit limitations applies only if the ESOP that acquires the stock of the loss company has as participants no less than 50 percent of the average number of employees employed by the old loss corporation during the 3-year period prior to the date of the ESOP acquisition for which the ESOP exception is sought. For purposes of this provision, except as provided by the Secretary of the Treasury, all employees of members of an affiliated group which includes the loss company and which files a consolidated return shall be treated as employees of the loss company.

Effective date

The provision applies to acquisitions occuring after December 31, 1988 unless pursuant to a binding written contract in effect on October 21, 1988.

M. Miscellaneous Provisions

1. Repeal of limitation on Treasury long-term bond authority

Present Law

The Secretary of the Treasury is allowed to issue up to $270 billion in bonds (obligations that mature more than 10 years after issue date) with interest rates above the 4 1/4 percent statutory limit. Bonds held by the public are subject to the limitation; bonds held in Federal Government agency and Federal Reserve System accounts are not included in the limit.

The last prior increase in the exception, from $250 billion to $270 billion, was enacted in the Omnibus Budget Reconciliation Act of 1987. An exception to the statutory limit was enacted initally in 1971 and was applied only to bonds held by the general public in 1973.

House Bill

The statutory limitation on the Treasury's authority to issue long-term bonds is repealed, effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Bad debt reserve exception for small banks

Present Law

A large bank is not allowed a deduction for an addition to a reserve for bad debts. A bank is a large bank if, for the taxable year, or any preceding taxable year beginning after December 31, 1986, the bank (or the parent-subsidiary controlled group of which it was a member) exceeds a certain size.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, if a bank which is a member of an affiliated group is sold to persons who did not, directly or indirectly, own any interest in any member of the affiliated group, the determination of whether a bank is a large bank for this purpose would be made without regard to the size of the bank before such sale.

The provision is effective as if included in the 1986 Act.

Conference Agreement

The conference agreement follows the House bill.

3. One-year extension of placed in service rule for nonconventional fuels production tax credit

Present Law

Section 29 provides a production credit up to $3 per barrel of oil equivalent for qualified nonconventional fuels. Such fuels include oil or natural gas produced from unusual geologic formations and synthetic fuels derived from coal (including lignite). Among other things, the amount of the production credit phases out as the unregulated annual average U.S. wellhead price per barrel of domestic crude oil rises above $23.50 (as adjusted for inflation since 1979).

The production credit is available generally to qualified fuels which are produced in a facility placed in service after December 31, 1979, and before January 1, 1990, or from a well drilled after December 31, 1979, and before January 1, 1990, and which are sold after December 31, 1979, and before January 1, 2001.

House Bill

Certain qualified fuels will be eligible for the production credit, if produced from a facility placed in service or a well drilled one year later than the expiration date in present law, namely, a well drilled or a facility placed in service before January 1, 1991.

The change is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

The conference agreement adds a clarification of section 29(d)(4)(A) to provide that the limitation therein would only operate to disqualify from the production credit for nonconventional fuel a nonconventional fuel produced from a property after December 31, 1979, if a nonconventional fuel of the same type was produced from the same property before January 1, 1980. The limitation would not apply where a nonconventional fuel of a different type from a different geological formation was produced after December 31, 1979. For example, if a coal seam gas well was drilled and completed after December 31, 1979, but before January 1, 1991, and produced coal seam gas from the same property from which another well produced marketable quantities of tight formation gas before January 1, 1980, the gas produced from the coal seam gas well will constitute a qualified fuel for purposes of section 29(a).

4. Carryover of nonconventional fuels credit under minimum tax

Present Law

The nonconventional fuels credit cannot reduce the taxpayer's tax liability to less than the amount of the minimum tax. Carryovers of unused credits are not allowed.

House Bill

No provision.

Senate Amendment

The credit for prior year minimum tax liability (sec. 53) will be increased by the amount of the nonconventional fuels credit not allowed for the taxable year solely by reason of the limitation based on the taxpayer's tentative minimum tax. The provision is effective for taxable years beginning after December 31, 1986.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Certain discharge of debt income not included in adjusted book income

Present Law

The alternative minimum taxable income of a corporation is increased by one-half of the excess of pre-tax book income over other alternative minimum taxable income for taxable years beginning in 1987, 1988, and 1989.

House Bill

The House bill provides that the transfer of a corporation's own stock in exchange for the corporation's debt in a Title 11 case (or to the extent the corporation is insolvent) does not give rise to adjusted net book income. The provision is effective for taxable years beginning after December 31, 1986.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

6. Treatment of certain corporations that are engaged in the sale of residential lots or timeshares for purposes of the alternative minimum tax

Present Law

For taxable years beginning in 1987, 1988, and 1989, the alternative minimum taxable income of a corporation is increased by 50 percent of the excess of the adjusted net book income of the corporation over the alternative minimum taxable income of the corporation (determined before application of the book income adjustment). The adjusted net book income of a corporation is based on the net income or loss set forth on the applicable financial statement of the corporation, and, consequently, in determining adjusted net book income, the installment method may be used in reporting gain from the sale of property.

For taxable years beginning after 1989, the alternative minimum taxable income of a corporation is increased by 75 percent of the excess of the adjusted current earnings of the corporation over the alternative minimum taxable income of the corporation (determined before application of the adjusted current earnings provision). In determining adjusted current earnings, the installment method may not be used.

For regular tax purposes and for purposes of determining alternative minimum taxable income (before application of the book income adjustment or the adjusted current earnings provision), the installment method may be used to report gain from certain sales of residential lots or timeshares if the taxpayer elects to pay interest on the amount of deferred tax that is attributable to the use of the installment method.

House Bill

No provision.

Senate Amendment

For taxable years beginning after 1989, the book income adjustment (rather than the adjusted current earnings provision) under the corporate alternative minimum tax applies to any corporation that elected before October 11, 1988, to use the installment method to report gain from certain sales of residential lots or timeshares and to pay interest on the tax that is deferred under the installment method. The provision applies to taxable years beginning after 1989 (the effective date of the adjusted current earnings provision).

Conference Agreement

The conference agreement follows the House bill.

7. Deductibility of adoption expenses

Present Law

Present law does not allow a tax deduction for adoption fees, court costs, attorney fees, or similar expenditures incurred in the adoption of a child. The Tax Reform Act of 1986 repealed a provision that had allowed an itemized deduction for up to $1,500 in such expenses incurred by an individual in the legal adoption of a child with special needs.

House Bill

No provision.

Senate Amendment

The Senate amendment includes a Sense of the Senate Resolution stating that consideration should be given to providing a tax deduction for qualified adoption expenses in order to encourage and facilitate adoptions.

Conference Agreement

The conference agreement follows the Senate amendment with a modifying amendment stating the sense of the Congress that consideration should be given to providing a tax deduction for qualified adoption expenses in order to encourage and facilitate adoptions.

8. Status of certain dependent care providers

Present Law

In general, the determination of whether an employer-employee relationship exists for Federal tax purposes is made under a common law test. Under this test, an employer-employee relationship generally exists if the person contracting for services has the right to control not only the result of the services, but also the means by which that result is accomplished.

House Bill

No provision.

Senate Amendment

The Federal Government, any State or political subdivision, the District of Columbia, or any agency or instrumentality of the foregoing may treat a person who renders dependent care or similar services as other than an employee for employment tax purposes if the following conditions are satisfied:

(1) The person does not provide any dependent care or similar services in any facility owned or operated by the governmental entity;

(2) The person is compensated by the governmental entity for such services, directly or indirectly, out of funds provided pursuant to Chapter 7 of Title 42 of the United States Code, or the provisions and amendments made by the Family Security Act of 1988;

(3) The governmental entity does not treat the person as an employee for employment tax purposes;

(4) The governmental entity files all Federal income tax returns (including information returns) required to be filed with respect to

such person on the basis consistent with the treatment of such person as other than an employee; and

(5) No more than 10 percent of the employees of the governmental entity are provided with insurance under Title II of the Social Security Act pursuant to voluntary agreements with the Secretary of Health and Human Services under section 218 of such Title.

The Secretary of Treasury is to report to the Senate Committee on Finance and the House Committee on Ways and Means on the tax status of any day care providers compensated pursuant to the programs described above no later than December 31, 1989.

The provision is effective on the date of enactment and applies to the period beginning on January 1, 1984, and ending on December 31, 1990.

Conference Agreement

The conference agreement follows the Senate amendment.

E. Estate Tax Provisions

1. Disallow marital deduction when spouse is not a citizen of the United States.

Present Law

For U.S. citizens and residents, a deduction is allowed for Federal estate and gift tax for the value of property passing from the decedent to the surviving spouse, regardless of the spouse's citizenship. For nonresident aliens, no marital deduction is allowed for estate and gift tax purposes.

For U.S. citizens, section 2013 provides a credit for a portion of estate tax paid with respect to property transferred to the decedent by or from a person who died within ten years, before or within two years after, the decedent's death.

House Bill

The House bill denies the marital deduction for Federal estate tax purposes for property passing to an alien spouse. The bill also provides that gifts to an alien spouse exceeding $100,000 per year are taxable under the Federal gift tax.

To the extent that the marital deduction is denied because the surviving spouse is an alien, the estate of that spouse who is entitled to a section 2013 credit for the full amount of estate tax paid with respect to property received from the decedent spouse's estate, determined without regard to when the decedent spouse died.

The bill allows a marital deduction for Federal estate tax purposes for property passing from a nonresident alien to a spouse who is a U.S. Citizens.

Senate Amendment

The Senate amendment follows the House bill, except that property passing at death to an alien spouse is excluded from the decedent's gross estate if situated in the United States and placed in a trust with a U.S. trustee in which the surviving spouse has a qualifying income interest for life. The value of such property is reduced by the amount of liability transferred with such property.

Transfers of property by the trustee are subject to an estate tax equal to the additional estate tax which would have been imposed had the distributed amount (together with previously distributed amounts) been includible in the decedent's estate. Trust income (as determined under the terms of the governing instrument and applicable local law) which is distributed prior to the surviving spouse's death is not subject to this tax.

Property held in trust is treated as having been transferred if the trustee ceases to be a U.S. citizen, or if the property is removed from the United States. When the estate tax on the decedent's estate has not yet been determined, the estate tax imposed equals the value of the transferred property times the highest estate tax rate (i.e., 55 percent under rates in effect for decedents dying in 1988) in effect at the time of the decedent's death. The section 2013 credit is available with respect to the estate tax, but with the limitations placed upon the credit under present law.

Conference Agreement

The conference agreement follows the Senate amendment and the House bill with respect to common provisions. In addition, the conference agreement contains the following modifications.

Under the conference agreement, the marital deduction is allowed for property passing to an alien spouse in a qualified domestic trust. Property passing outside the probate estate is treated as passing in a qualified domestic trust if transferred to such a trust before the estate tax return is due.

A qualified domestic trust must meet four conditions.

First, the trust instrument must require that all trustees be U.S. citizens or domestic corporations.

Second, the surviving spouse must be entitled to all the income (as determined under the terms of the governing instrument and applicable local law) from the property in the trust, payable annually or at more frequent intervals.

Third, the trust must meet the requirements of Treasury regulations prescribed to ensure collection of the estate tax imposed upon the trust. It is expected that the Treasury regulations will require that sufficient trust assets be subject to U.S. jurisdiction so as to ensure collection of estate tax with respect to the trust. The regulations might, for example, require that a portion of trust property to be situated in the United States or that the trustee be an institution with substantial U.S. assets.

Fourth, the executor must make an election with respect to the trust. This election must be made on the estate tax return and, once made, is irrevocable.

An estate tax is imposed upon corpus distributions from the trust made prior to the date of the surviving spouse's death and upon the value of property remaining in a qualified domestic trust upon the date of the surviving spouse's death. The tax is also imposed up on the trust property if a person other than a U.S. citizen or domestic corporation becomes a trustee of the trust or if the trust ceases to meet the requirements prescribed by the Secretary of the Treasury.

The amount of the estate tax is the additional estate tax which would have been imposed had the property subject to the tax been included in the decedent spouse's estate. If the estate tax for the decedent spouse's estate has not been finally determined,[1] a tentative tax is imposed using the highest estate tax rate in effect as of the date of the decedent's death. When the decedent spouse's estate tax liability is finally determined, the excess of the tentative tax over the additional estate tax which would have been imposed had the property been included in the decedent's estate tax is refundable.

The estate tax is due on the 15th day of the fourth month in the calendar year following the end of the taxable year in which the taxable event occurs. The trustee is personally liable for the estate tax, and may, under rules similar to section 2204, discharge his liability upon written application to the Secretary of the Treasury.

The tax imposed by this provision is treated as an estate tax with respect to the decedent spouse's estate. As such, it qualifies for the previously paid property tax, determined without regard to the date of the decedent spouse's death. In addition, there is a lien against property giving rise to such tax for ten years from the taxable event.

VI. RAILROAD UNEMPLOYMENT AND RETIREMENT PROVISIONS

A. Railroad Unemployment Amendments

Present Law

The Railroad Unemployment Insurance Act of 1938 established a separate unemployment compensation program for the rail industry. It imposes payroll taxes on railroads to finance benefits for unemployed railroad workers. The following tax and benefit provisions of present law would be amended by the Conference agreement:

(1) *Compensation base.*—$600 is the maximum monthly amount of earnings of each employee for purposes of computing the tax which supports the railroad unemployment program and for purposes of determining whether the employee has sufficient base year wages to qualify for benefits.

(2) *Tax rates.*—Railroad employers pay a uniform tax of 8 percent of the compensation base to support the railroad unemployment program. (The uniform rate can vary from year to year in a range of 0.5 to 8 percent, but has been at 8 percent since January 1, 1981.)

(3) Commuter railroads pay unemployment taxes on the same basis as other railroads.

(4) The administrative costs of the program are financed by a tax of 0.5 percent.

---

[1] A tax is not finally determined for these purposes if, for example, the statute of limitations for the decedent spouse's estate tax has not lapsed, or judicial determination of such tax is pending. A tax may be finally determined by a closing agreement.

(5) In addition to other taxes, railroads now pay a special tax designed to repay the borrowings of the unemployment program from the railroad retirement program. This tax is 6 percent in 1988, 2.9 percent in 1989, and 3.2 percent in January-September of 1990. The tax is scheduled to expire after September 30, 1990.

(6) If there is any further borrowing by the unemployment program from the retirement program, a surtax of 3.5 percent would automatically go into effect. The surtax is not currently in effect.

(7) Present law has no waiting period for railroad unemployment benefits.

(8) Unemployment benefits are payable at a rate of $25 per day.

(9) To qualify for unemployment benefits, an individual must have earned at least $1,500 in creditable wages in the base year. (This the equivalent of 2.5 months under the present law compensation base of $600, and thus requires employment in at least 3 months of the base year.)

House Bill

No provision in H.R. 4333. (A separate House-passed bill—H.R. 2167—contains largely identical provisions to the Senate amendment except that the House bill's effective dates are generally one year earlier and certain differences noted below with respect to the numbered items.)

(1-6) No differences.

(7) H.R. 2167 provides for a 9-day waiting period for railroad unemployment benefits.

(8) No difference.

(9) H.R. 2167 requires approximately 6 months of qualifying employment in the base year.

Senate Amendment

(1) *Compensation base.*—Starting with 1989, the compensation base will be automatically increased each year by ⅔ of the rise in wage levels in the economy using the same index as applies to the social security tax base. Conforming changes are made to the definition of subsidiary remuneration, to the maximum annual benefit amount, and to the amount of earnings required to terminate a disqualification.

(2) *Tax rates.*—The tax rate will remain at 8 percent through 1990. Starting with 1991, the tax rate will begin to be based on an experience rating formula under which tax rates vary among employers according to the amount of benefits that have been paid to their employees. The experience rating system becomes fully effective starting in 1993. The computation of each employer's tax liability will be adjusted to cover benefit costs which cannot be allocated to individual employers or which are not fully covered because of an overall 12 to 12.5 percent cap on individual employer rates. Employers will be afforded an opportunity to appeal the award of benefits to their employees.

(3) For 1989 and 1990, public commuter railroads will be exempt from paying the 8 percent tax and will instead reimburse the unemployment system for the amount of benefits paid during the

year to their employees. Starting in 1991, those railroads will again pay taxes on the same basis as other railroads.

(4) The tax to cover administrative costs is increased from 0.5 percent to 0.65 percent.

(5) The rate of the repayment tax is changed to 4 percent effective with 1989, and it stays in effect until all borrowing by the railroad unemployment system from the railroad retirement system prior to October 1, 1985 has been repaid with interest.

(6) The present law contingent surtax of 3.5 percent is eliminated starting in 1991. Instead, there will be a surcharge added to employers' unemployment taxes whenever the balance in the unemployment account as of the previous June 30 is less than $100 million. The surcharge rate will range from 1.5 to 3.5 percent depending on how low the balance has fallen.

(7) No benefits will be payable during the first 2-week registration period each year in which the individual has more than four days of unemployment. A similar rule will apply to sickness benefits. In effect, this provision represents a 2-week waiting period for unemployment and sickness benefits.

(8) Effective July 1, 1988, the daily unemployment benefit rate is increased to $30. Starting in July of 1989, this amount will be indexed by ⅔ of the growth of wages in the general economy using the same index that is used to increase the social security taxable wage base.

(9) The $1,500 base year earnings requirement is changed to a requirement of 2.5 times the indexed compensation amount. This has the effect of continuing to require employment in at least 3 months of the base year.

Conference Agreement

The conference agreement generally follows the Senate amendment with respect to the above items, except that the reporting date for the Railroad Retirement Reform Commission authorized under P.L. 100–203 would be extended one year from October 1, 1989 to October 1, 1990.

B. Railroad Retirement Provisions

Present Law

(1) Certain individuals retiring from railroad employment receive a severance payment which is subject to the tier II railroad retirement tax even though the individual gets no additional service-month credit because of that payment.

(2) Railroad retirement benefits (including spouses benefits) are not payable for months in which the retiree works for his or her last non-railroad employer.

(3) Disability annuitants lose benefits for any month in which they have earnings of more than $200 for the month and more than $2,400 for the year.

(4) Military service credit is given under the railroad retirement system to certain individuals previously in rail employment if their military service occurred in a war period. The period of June 15, 1948 to December 15, 1950 is not considered a war period.

House Bill

No provision in H.R. 4333. (A separate House-passed bill—H.R. 2167—contains largely identical provisions to the Senate amendment, except that the House bill's effective dates are generally one year earlier.)

Senate Amendment

(1) A lump-sum refund to employees will be made equal to the tier II taxes paid on severance payments which do not result in additional service-month credit. This applies to such payments made on or after January 1, 1985.

(2) The "last person service" rule is eliminated. Instead, tier II benefits are reduced by 50 percent of any earnings from the individual's last non-railroad employer. The total reduction in tier II plus supplemental benefits cannot be more than 50 percent.

(3) The earnings limit on disability annuities is increased to $400 for the month and $4,800 for the year. In determining these amounts, disability related work expenses are excluded.

(4) The June 15, 1948 to December 15, 1950 period is added to what is considered to be a war period in the case of individuals who returned to railroad employment in the year in which their military service ended or in the following year.

Conference Agreement

The conference agreement generally follows the Senate amendment.

C. Reports and Study

Present Law

No provision.

House Bill

No provision in H.R. 4333. (A separate House-passed bill—H.R. 2167—contains largely identical provisions to the Senate amendment.)

Senate Amendment

(1) The Railroad Retirement Board is directed to make annual reports to Congress on the status of the railroad unemployment insurance system. The annual reports are due by July 1 of each year, beginning in 1989.

(2) The Comptroller General is directed to conduct a study to determine the extent and impact of fraud and payment error in the railroad unemployment program. The report is due not later than one year after date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

VII. SOCIAL SECURITY AMENDMENTS; MEDICARE AND MEDICAID AMENDMENTS

A. Social Security Act Amendments

1. Interim benefits in cases of delayed final decisions

Present Law

If, upon appeal, an individual receives an unfavorable determination regarding disability benefits from an Administrative Law Judge (ALJ), he or she may appeal the ALJ's decision to the Social Security Administration's Appeals Council. If, on the other hand, the individual receives a favorable determination from the ALJ, the Appeals Council may review the determination on its "own motion". No disability benefits are paid while a case is under review by the Appeals Council.

House Bill

In any disability case under Title II or Title XVI of the Social Security Act in which an ALJ has made a decision favorable to the individual and the Appeals Council has not rendered a final decision within 110 days, interim benefits would be provided to the individual. (Delays in excess of 20 days caused by or on behalf of the claimant would not count in determining the 110 day period.) These benefits would begin with the month before the month in which the 110-day period expired, and would not be considered overpayments if the final decision were adverse, unless the benefits were fraudulently obtained.

The provision would be effective with respect to favorable ALJ decisions made 180 days or more after enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Application of earnings test in year of individual's death

Present Law

A social security beneficiary under age 70 with earnings in excess of certain thresholds is subject to a $1 reduction in benefits for every $2 earned over the exempt amount. The annual exempt amount under the earnings test is lower for beneficiaries under age 65 than for those 65–69. In 1988, the exempt amount for those under age 65 is $6,120, and the age 65–69 exempt amount is $8,400. The higher exempt amount is applicable in the year a beneficiary reaches age 65.

If a beneficiary dies, the annual exempt amount applicable at the time of death is prorated based on the number of months that he or she lived during the year. In addition, the lower exempt amount applies if a beneficiary dies before his or her birthdate in the year the beneficiary would have turned 65. Thus, overpayments can occur when beneficiaries die unexpectedly and the thresholds on earnings are lower than anticipated.

House Bill

The annual exempt amount would not be prorated in the year of death. In addition, the higher annual exempt amount for beneficiaries age 65–69 would apply to people who die before their birthdate in the year that they otherwise would have attained age 65.

The provision would be effective with respect to deaths after the date of enactment.

Senate Amendment

No provision.

Conference Report

The conference agreement follows the House bill.

3. Phase-out of reduction in "windfall" benefit

Present Law

Under the "windfall" benefit provision of the Social Security Amendments of 1983, social security benefits are generally reduced for workers who also have pensions from work that was not covered under social security (e.g., work under the Federal Civil Service Retirement System). Under the regular, weighted benefit formula, benefits are determined by applying a set of declining percentages to average indexed monthly earnings. For workers who reach age 62 in 1988, a worker's basic benefit is equal to 90 percent of the first $319 of average indexed monthly earnings, 32 percent of earnings from $319 through $1,922, and 15 percent of earnings above $1,922. The formula applicable to those with pensions from noncovered employment substitutes a rate of 40 percent for the 90-percent rate in the first bracket. (The second and third factors of the formula remain the same.) The resulting reduction in the worker's social security benefit is limited to one-half the amount of the noncovered pension. The new law is being phased in over a 5-year period, beginning with those persons first eligible for social security benefits in 1986.

Workers who have 30 years or more of substantial social security coverage are fully exempt from this treatment. For workers who have 26–29 years of coverage, the percentage in the first bracket in the formula increases by 10 percentage points for each year over 25, as illustrated below:

Years of social security coverage:	*First factor in formula (percent)*
25 or fewer	40
26	50
27	60
28	70
29	80
30 or more	90

House Bill

The years of social security coverage required in order for an individual to be exempt from the windfall benefit formula would be lowered from 30 to 25 years. Similarly, the years of coverage at which the formula gradually takes effect would be scaled back, as illustrated below:

Years of social security coverage:	First factor in formula (percent)
20 or fewer	40
21	50
22	60
23	70
24	80
25 or more	90

The provision would be effective for benefits payable for months after December 1988.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the reduction would be phased out in five percent increments between 20 and 30 years of coverage, as follows:

Years of social security coverage:	First factor in formula (percent)
20 or fewer	40
21	45
22	50
23	55
24	60
25	65
26	70
27	75
28	80
29	85
30 or more	90

4. Denial of benefits to individuals deported or ordered deported on the basis of association with the Nazi government of Germany during World War II

Present Law

People who are deported for violating specified provisions of the Immigration and Nationality Act lose their social security benefits. The list of provisions for which people are denied benefits does not, however, include paragraph 19 of that Act. Paragraph 19, which was added to the Immigration and Nationality Act of 1978, pertains to people deported for certain activities in association with the Nazi government of Germany during World War II.

House Bill

Benefits to individuals deported as Nazi war criminals under paragraph 19 of the Immigration and Nationality Act would be terminated.

The provision would apply only in the case of deportations occurring and final orders of deportation issued, on or after the date of enactment, and only with respect to benefits beginning on or after such date.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Amendment

The conference agreement follows the House bill and the Senate amendment.

5. Modification in the term of office of public members of the Social Security Boards of Trustees

Present Law

The Boards of Trustees of the Social Security Trust Funds are composed of the Secretaries of the Treasury, Labor, Health and Human Services, and two members of the public. The members of the public are nominated by the President and confirmed by the Senate. The law specifies that their term of service is for four years, but is otherwise silent on the length of term for a public member appointed to fill a vacancy before the end of his or her term. The law is likewise silent on whether a public member is permitted to serve after the expiration of his or her term until a successor has taken office.

House Bill

A public member appointed to fill a vacancy occurring before the end of a term would be appointed only for the remainder of such term. A public member, whether appointed for a full term or appointed to fill an unexpired term, would be permitted to serve after the expiration of that term until a successor had taken office.

The provision would be effective upon enactment.

Senate Amendment

The Senate amendment is similar to the House bill, except that a trustee could serve beyond the expiration of his or her term only until the earlier of the issuance of the next report of the Boards of Trustees or the date on which a successor takes office.

Conference Agreement

The conference agreement follows the Senate amendment.

6. Continuation of disability benefits during appeal

Present Law

A disability insurance beneficiary who is determined to be no longer disabled may appeal the determination sequentially through three appellate levels within the Social Security Administration (SSA): a reconsideration, usually conducted by the State Disability Determination Service that rendered the initial unfavorable determination; a hearing before an SSA Administrative Law Judge (ALJ); and a review by a member of SSA's Appeals Council.

The beneficiary has the option of having his or her benefits continued through the hearing stage of appeal. If the earlier unfavorable determinations are upheld by the ALJ, the benefits are subject to recovery by the agency. (If an appeal is determined to be in good faith, benefit repayment may be considered for waiver.) Medicare eligibility is also continued, but medicare benefits are not subject to recovery.

The Omnibus Budget Reconciliation Act of 1987 extended this provision for one year. The Act authorized the payment of interim benefits to persons in the process of appealing termination decisions made before January 1, 1989. Such payments may continue through June 30, 1989 (i.e., through the July 1989 check).

House Bill

The period in which disability benefits may be paid, and medicare eligibility continued, while an appeal is in progress would be extended for one additional year. Upon application by the beneficiary, benefits would be paid while an appeal is in progress with respect to unfavorable determinations made on or before December 31, 1989, and would be continued through June 1990 (i.e., through the July 1990 check).

The provision would be effective with respect to unfavorable decisions made on or before December 31, 1989.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

7. Extend social security exemption for members of certain religious faiths

Present Law

Self-employed workers may claim an exemption from social security coverage if they are members of a religious sect or division that is conscientiously opposed to the acceptance of public or private insurance benefits, if they have waived all benefits under Titles II and XVIII, and if the sect or division has been in existence since December 31, 1950, and provides for the care of its dependent members (e.g., the Amish). Employees who belong to such religious sects, however, are required to participate in social security.

House Bill

The provision would extend the current-law treatment of the self-employed to their employees in cases where both the employee and the employer are members of a qualifying religious sect or division. The optional exemption would apply to both the employer and employee portion of the tax.

The provision would apply to taxable years beginning on or after January 1, 1989.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

8. Blood donor locator service

Present Law

Government agencies may require individuals to furnish social security numbers (SSNs) only for certain specified purposes. States are authorized to require SSNs to administer tax, public assistance, drivers' license and motor vehicle registration laws.

House Bill

States or authorized blood donation facilities (those licensed or registered with the Food and Drug Administration, such as the Red Cross) would be permitted to require donors to furnish SSNs. The Secretary of Health and Human Services (HHS) would be required to establish and operate a Blood Donor Locator Service, under the direction of the Commissioner of Social Security, to be used to obtain and transmit the most recent mailing address of any blood donor whose blood shows that he or she may be carrying the virus for acquired immune deficiency syndrome (AIDS), for the sole purpose of informing the blood donor of the possible need for medical care and treatment.

The provision would permit access to the address information only to State agencies and blood donation facilities meeting requirements for confidentiality and security.

The Secretary of HHS would be required to establish the Blood Donor Locator Service no later than 180 days after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

9. Payment of lump-sum death benefits to legal representatives of widows and widowers who die before receiving payment

Present Law

A lump-sum death payment of $255 is payable on the death of an insured worker to a surviving spouse who is living with the worker at the time of the worker's death. If there is no such spouse, then the benefit is payable to a surviving spouse who is eligible for benefits as a widow(er), mother, or father at the time of the worker's death. If there is no eligible spouse, the lump-sum death payment is payable to a child of the deceased worker who was eligible to receive benefits on the deceased's earnings record at the time of the worker's death. If the widow(er) dies before making application for the lump-sum payment or before negotiating the benefit check, no lump-sum death benefit is payable.

House Bill

The provision would permit the legal representative of the estate of a deceased widow(er) to claim the lump-sum payment in cases in which the otherwise eligible widow(er) dies before having both received and negotiated such payment. Where the legal representative of the estate is a State or political subdivision of a State, the lump-sum benefit would not be payable.

The provision would be effective with respect to deaths of widow(er)s occurring on or after January 1, 1989.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House provision.

10. Requirement of social security number as a condition for receipt of social security benefits

Applicants for social security benefits are not required to have social security numbers (SSNs) in order to receive benefits. The absence of an SSN for auxiliary and survivor beneficiaries hampers monitoring which might detect duplicate benefit payments, unreported earnings, or entitlement to other benefits.

The SSA currently requests that applicants voluntarily provide their SSNs. Under Federal law, recipients of Aid to Families with Dependent Children, Supplemental Security Income, and Veterans' Assistance benefits are currently required to provide their SSNs in order to receive benefits under those programs.

House Bill

Individuals would be required to have an SSN in order to receive social security benefits. Those lacking an SSN would be required to apply for one. Beneficiaries currently on the rolls would not be subject to this requirement.

The provision would be effective with respect to benefit entitlements commencing after the sixth month following the month of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

11. Substitution of certificate of election for application to establish entitlement for certain reduced widow's and widower's benefits

Present Law

An individual who (1) is receiving a combination of a reduced spouse's benefit and either retirement or disability benefits on his or her own record and (2) is between the ages of 62 and 65 when his or her spouse dies, must file an application to receive reduced widow(er)'s benefits.

Those who are over age 65 when the worker dies and who are receiving spouses' benefits or those age 62–65 when the worker dies who are not entitled to their own retirement or disability benefits may receive reduced widow(er)s' benefits by filing a certificate of election rather than an application.

An application for a reduced widow(er)'s benefit is generally not effective for months before the month of filing. Thus, a break in entitlement could occur if the application were not filed in a timely fashion.

House Bill

An individual who is receiving both a reduced spouse's benefit and a retirement or disability benefit and who is between the ages of 62 and 65 when his or her spouse dies, could receive a reduced widow(er)'s benefit by filing a certificate of election. A certificate of election would be effective for up to 12 months before it is filed.

The provision would be effective with respect to benefits payable based on the record of individuals who die after the month of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

12. Calculation of windfall benefit guarantee amount based on pension amounts payable in the first month of concurrent entitlement rather than concurrent eligibility

Present Law

Under the windfall benefit provision, a special formula is used to compute the social security benefits of workers who are also eligible for pensions based on non- covered employment. The "windfall guarantee" assures that the resulting reduction in the social security benefit will not exceed one-half of the amount of the noncovered pension. The amount of the noncovered pension used in this calculation is the amount payable in the first month the individual is *eligible* for both the pension and social security (i.e., the first month he or she could receive both of these benefits if he or she applied for them—the month of "concurrent eligibility"). This amount is used regardless of whether the individual actually receives (i.e., is *entitled* to) the benefits at that time.

To compute an individual's benefits, the Social Security Administration must ask the individual's pension administrator to determine the pension amount that would have been payable at the date of first concurrent eligibility for both the pension and social security (usually age 62) regardless of the pension amount which the person will actually receive upon entitlement. Processing delays and errors can occur when pension administrators make this fictitious computation of the pension amount.

House Bill

The amount of the pension considered when determining the windfall guarantee would be the amount payable in the first month of concurrent *entitlement* to both social security and the pension from noncovered employment.

The provision would be effective for benefits based on applications filed after the month in which this Act is enacted.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

13. Consolidation of reports on continuing disability reviews

Present Law

The Secretary of Health and Human Services is required to make two types of reports on continuing disability reviews to the Senate Committee on Finance and House Committee on Ways and Means. The first is a semiannual report on the results of continuing disability reviews. The second is an annual report on the appropriate number of disability cases to be reviewed in each State.

House Bill

The frequency of the report on the results of continuing disability reviews would be changed from semiannual to annual.

The provision would be effective with respect to reports required to be submitted after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. The conferees intend this change to allow the two reports on continuing disability reviews to be consolidated into one annual report to the Senate Committee on Finance and the House Committee on Ways and Means. The conferees also intend that this report remain separate from the Social Security Administration's Annual Report to the Congress.

14. Exclusion of employees separated from employment before January 1, 1989, from rule including as wages taxable under FICA certain payments for group-term life insurance

Present Law

The Omnibus Budget Reconciliation Act of 1987 required the cost of employer-provided group-term life insurance to be included in wages for FICA tax purposes if it is includible for income tax purposes. Under current law, it is includible for income tax purposes to the extent that coverage exceeds $50,000.

House Bill

Group-term life insurance provided to individuals who separated from service before January 1, 1989 would be excluded from FICA tax.

The provision would be effective with respect to separations from service before January 1, 1989.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

15. Treatment of earnings of corporate directors

Present Law

The Omnibus Budget Reconciliation Act (OBRA) of 1987 provides that corporate directors' earnings shall be treated as received when earned, regardless of when actually paid, for purposes of both the social security tax and the social security retirement test. Prior to OBRA, because corporate directors' earnings were treated as self-employment income, directors were able to defer the impact of

FICA taxation and avoid benefit reductions from the retirement test by deferring receipt of earnings until reaching age 70.

House Bill

The portion of the 1987 OBRA provision that treats directors' earnings as received when earned, and thus taxable for social security purposes, would be repealed. Directors' earnings would be treated as received when earned only for purposes of the social security retirement test.

The provision would be effective as if it had been included in OBRA of 1987 at the time of its enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House provision.

16. Clarification of applicability of government pension offset to certain Federal employees

Present Law

Social security benefits payable to spouses of retired, disabled, or deceased workers are reduced to take account of any public pension the spouse receives as a result of work in a government job not covered by social security. The amount of the reduction is equal to two-thirds of the government pension.

Generally, Federal workers hired before 1984 are part of the Civil Service Retirement System (CSRS) and are not covered by social security. Most Federal workers hired after 1983 are covered by the Federal Employees' Retirement System Act of 1986 (FERS), which includes coverage by social security. The FERS law provided that workers covered by the CSRS could, from July 1, 1987 through December 31, 1987, make a one-time election to join FERS. Because the law generally provides that the offset does not apply to workers whose government job is covered by social security on the last day of the person's employment, a CSRS employee who switched to FERS during this period immediately became exempt from the government pension offset. This exemption, however, was only available if the election to change to FERS actually took effect prior to the date of the individual's retirement. The Omnibus Budget Reconciliation Act (OBRA) of 1987 provided that employees who elect to join FERS during any election period which may occur after 1987 would be exempt only if they have five or more years of Federal service covered by social security after June 30, 1987.

House Bill

The House bill would provide that any employee who elected FERS on or before December 31, 1987 would be exempt from the government pension offset even if that person retired from government service before their FERS coverage became effective.

In addition, the provision would make it clear that the 1987 OBRA provision applies not only to Federal employees who join FERS by electing to become subject to chapter 84 of title 5, United States Code, but also to foreign service employees who join FERS by electing to become subject to chapter 22 of title 1, United States Code.

The provision would be effective as if it had been included in OBRA of 1987 at the time of its enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

17. Clarification regarding social security coverage for certain civil servants

Present Law

(1) The Social Security Amendments of 1983 provided mandatory social security coverage for presidential appointees as well as the President, Members of Congress, Federal judges, and certain executive level civil servants. However, section 205(p) of the Social Security Act provides that the Secretary of Health and Human Services (HHS) shall accept the determination of the head of a Federal agency as to whether a Federal employee has performed service, as to the periods of such service, and as to the amount of remuneration which constitutes wages. The Office of Personnel Management (OPM) has interpreted this section to mean that a Federal agency may determine whether or not an employee's service constitutes social security covered employment. Because the civil service statute permits career Senior Executive Service (SES) employees to retain their pay, rank, and retirement plan when they move to a presidential appointment, OPM has interpreted section 205(p) to mean that such individuals may avoid social security coverage despite the coverage provisions of the 1983 Social Security Amendments (while retaining coverage under the old Civil Service Retirement System).

(2) When an individual accepts a mandatorily covered Federal job and subsequently returns to his or her previous job or another noncovered Federal job, he or she loses social security coverage.

House Bill

(1) The House bill would clarify that the Secretaries of HHS and Treasury, not the head of any other Federal agency, have the authority to make the final determination as to whether an individual's services constitute social security covered employment, including those of presidential appointees.

(2) In addition, the House bill would clarify that any civil servant who becomes covered by social security as a result of taking a mandatorily covered Federal job would retain social security coverage in any subsequent Federal job.

The first provision would be effective with respect to determinations relating to service commenced in any position on or after the date of enactment; the second provision would be effective with respect to service performed on or after the date of enactment in a position mandatorily covered by social security.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

18. Technical corrections in OASDI provisions

Present Law

There are miscellaneous minor and technical errors in the current OASDI provisions.

House Bill

The House bill makes minor and technical revisions in OASDI provisions.

The provisions generally would be effective upon enactment, except for certain provisions that would be effective as if included in the relevant public law at the time of its enactment.

Senate Amendment

The Senate amendment includes similar minor and technical revisions.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with technical changes.

19. National Academy of Social Insurance

Present Law

No provision.

House Bill

No provision.

Senate Amendment

The Senate amendment provides a Federal charter for the National Academy of Social Insurance (a tax-exempt corporation, organized and incorporated under the laws of the District of Columbia), with the objects and purposes of: (1) promoting an informed and nonpartisan study of, and education with respect to, social insurance; (2) bringing together experts with diverse backgrounds to consider social insurance in an interdisciplinary way; (3) assisting in the development of social insurance scholars and administrators;

(4) encouraging research and studies on topics of relevance to social insurance; and (5) sponsoring seminars and other public meetings.

The National Academy of Social Insurance is to report on its activities to Congress annually.

The provision would be effective upon enactment.

Conference Agreement

The conference agreement does not include the Senate provision.

20. Exemption from FICA tax for certain agricultural workers

Present Law

Cash wages paid by an employer to an employee for agricultural labor in any calendar year are subject to FICA tax if (1) the employee received cash remuneration of at least $150, or (2) the employer pays more than $2,500 to all employees for such agricultural labor during the taxable year.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, wages paid to an employee who receives less than $150 in annual cash remuneration by an agricultural employer would not be subject to FICA tax even if the employer pays more than $2,500 in the year to all employees, provided the employee: (1) is employed in agriculture; (2) is a hand harvest laborer; (3) is paid on a piece-rate basis; (4) is paid piece-rates in an operation which has been, and is customarily and generally recognized as having been paid on a piece-rate basis in the region of employment; (5) commutes daily from his or her permanent residence to the farm on which he or she is so employed; and (6) has been employed in agriculture less than 13 weeks during the preceding calendar year. These criteria are the same as those specified in section 13(a)(6)(C) of the Fair Labor Standards Act. The remuneration paid to employees exempt under this provision would nevertheless count toward the $2,500 test for purposes of determining the coverage of employees who do not meet the conditions for exemption under this provision.

The provision would be effective as if included in the amendments made by section 9002 of the Omnibus Budget Reconciliation Act of 1987 (i.e., for remuneration for agricultural labor paid after December 31, 1987.)

Conference Agreement

The conference agreement follows the Senate amendment with technical modifications.

21. Certain employer pension contributions not included in FICA wage base

Present Law

The 1983 Social Security Amendments provided that the payment by a State or local employer of employee contributions under a State or local retirement plan would be treated as wages subject to employment taxes (FICA and FUTA). The Deficit Reduction Act of 1984 modified this provision to allow the exclusion from wages for employment tax purposes of any amounts paid by a State or local employer of employee contributions pursuant to a State "pick-up" plan unless the pickups were made pursuant to a salary reduction agreement. On the basis of the 1984 Act, some States established pick-up plans after obtaining letter rulings from the Internal Revenue Service to the effect that the pickups would not be considered wages for employment purposes. A subsequent review of the issue, in the light of statement of managers language in the conference report on the 1984 Act, led the Internal Revenue Service to reverse its position and to revoke the earlier letter rulings. In revoking the earlier letter rulings, the IRS indicated that the States affected could apply for relief from liability for employment taxes on the pickups with respect to the retroactive period prior to the revocation of the letter ruling.

House Bill

No provision.

Senate Amendment

The Senate amendment would relieve State or local governments from FICA tax liability for employer "pickups" subsequent to the effective date of the 1984 Act to the extent that the State did not pay the FICA taxes in good faith reliance on a letter ruling of the Internal Revenue Service.

The relief would apply only to pickups for which FICA taxes were not paid and only for the period ending with the earlier of the date of enactment of this provision or the receipt by the State or local government from the IRS of a notice of revocation of the letter ruling.

Conference Agreement

The conference agreement follows the Senate amendment, with technical modifications.

22. Required use of consumer price index for urban consumers by Federal officers or agencies in determining certain cost-of-living increases

Present Law

In determining cost-of-living adjustments (COLAs) in amounts of benefits or allowances in several Federal programs (including Social Security, supplemental security income (SSI), and railroad retirement), the administering agency uses the Consumer Price

Index for Urban Wage Earners and Clerical Workers, i.e., CPI-W. With respect to Social Security, SSI, and railroad retirement, COLAs are based on the percentage change in the CPI-W, measured from the average of the third quarter of one year to the average of the third quarter of the succeeding year.

House Bill

No provision.

Senate Amendment

Any Federal officer or agency that administers a Federal program that provides benefits or allowances which are adjusted periodically in consonance with the consumer price index would be required to use the Consumer Price Index for Urban Consumers, i.e., CPI-U.

The provision would not apply to a COLA formula which has been negotiated between any private or public (i.e., State or local government) employer and any labor union or employee association, nor to present or future actions relating to rights, benefits, or obligations between individuals, businesses, and State and local governments.

The provision would apply to any Federal cost-of-living adjustment payable in any month beginning on or after December 1, 1989.

Conference Agreement

The conference agreement does not include the Senate provision.

23. Report regarding disability applications involving AIDS related complex (ARC)

Present Law

No provision.

House Bill

No provision.

Senate Amendment

The Department of Health and Human Services would be required to report to the Committee on Ways and Means and the Committee on Finance concerning applications for social security disability benefits by persons with AIDS related complex (ARC).

The report would indicate the number of applications approved, denied (by reason for denial), and reversed on appeal for fiscal years 1988, 1987, and, to the extent feasible, 1986. Denial and allowance rates would be provided on a State and regional basis to the extent feasible. The report would also describe the criteria, guidelines and other information used to determine the eligibility of applicants suffering from ARC (including copies of relevant SSA documents), as well as information on any modifications in these criteria and guidelines which are under consideration. The cost of benefits for such persons during the years in question and projected costs for the coming three years would also be reported. Finally, a report would be required on what arrangement, if any, exists for coordination between the Social Security Administration and State disability insurance programs to make individuals with ARC aware of the benefits which may be available to them under Federal and State programs.

The provision would be effective upon enactment and the required report due no later than six months thereafter.

Conference Agreement

The conference agreement follows the Senate amendment.

B. Public Assistance Provisions

1. Moratorium on emergency assistance and AFDC special needs regulations

Present Law

States may operate an emergency assistance program for needy families with children (whether or not eligible for AFDC), if the aid is needed to avoid the child's destitution or to provide living arrangements in a home for the child. The law authorizes 50-percent Federal matching funds for emergency assistance "furnished for a period not in excess of 30 days in any 12-month period." Current regulations state that Federal matching funds are available for emergency assistance "which the State authorizes during one period of 30 consecutive days in any 12 consecutive months, including payments which are to meet needs which arose before such 30-day period or are for such needs as rent which extend beyond the 30-day period."

Current AFDC regulations also allow States to include in their standards of need provision for meeting "special needs" of applicants and recipients. The State plan must specify the circumstances under which such payments will be made.

On December 14, 1987, the Department of Health and Human Services published in the *Federal Register* a proposed regulation that would have restricted use to AFDC emergency assistance funds for homeless families and limited States' authority to make payments for special needs to AFDC recipients. The proposed rules would have prohibited emergency assistance to cover needs over a period in excess of 30 days per year (permitting aid only "to meet the actual expense of needs in existence" during the 30-day period). The proposed rules also would have forbidden the States to include in their standard of need, as a special or basic need, an amount for shelter varied according to the type of housing (for example, house vs. hotel).

The Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203) established a moratorium under which the Secretary of Health and Human Services was directed not to implement the proposed regulations or otherwise modify current policy regarding the subject of those regulations before October 1, 1988.

House Bill

No provision in H.R. 4333. (A separate House-passed bill—H.R. 4352—has a provision identical to the Senate amendment.)

Senate Amendment

The Senate amendment extends the moratorium on changing current policy regarding emergency assistance and special needs for homeless families to October 1, 1989.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Disregard of certain housing assistance for SSI recipients

Present Law

Under the SSI program, assistance is provided to needy, aged, blind, and disabled persons to bring their income up to certain amounts set in Federal and State law. In determining eligibility and benefit amount, all income of an individual is taken into account unless it is specifically excluded by law.

For SSI purposes, housing aid provided under the United States Housing Act of 1937 is excluded from consideration as income or resources. The Housing and Community Development Act of 1987 (P.L. 100-242) transferred the authorization of housing assistance for the nonelderly disabled from the United States Housing Act of 1937 to the Housing Act of 1959, effective for projects developed and contracts made with funds appropriated after enactment. P.L. 100-242 did not, however, specifically exclude the consideration of this assistance as income or resources to SSI applicants or recipients under the newly-amended Housing Act of 1959.

House Bill

The House bill amends section 1612(b) of the Social Security Act to exclude from consideration as income or resources of SSI applicants or recipients assistance provided for housing under the United States Housing Act of 1937, the National Housing Act, section 101 of the Housing and Urban Development Act of 1965, Title V of the Housing Act of 1949, and section 202(h) of the Housing Act of 1959.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Moratorium on AFDC quality control sanctions

Present Law

Current law prescribes fiscal sanctions (withholding of some program matching funds) for State AFDC payment error rates that exceed tolerances. The law sets the tolerance level at 3 percent for the 50 States and the District of Columbia; regulations set the level at 4 percent for Guam, the Virgin Islands, and Puerto Rico. Fiscal sanctions have been assessed for past erroneous excess payments, but not collected. The Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272) prohibits the Department of Health and Human Services, until July 1, 1988, from reducing AFDC payments to States for excess errors identified by the AFDC quality control system. COBRA also required that two studies be undertaken (by the National Academy of Sciences and the Secretary of Health and Human Services) to examine how best to operate the quality control system so as to improve program administration and provide reasonable data on which to base sanctions. Both studies were completed in early 1988.

House Bill

The House bill extends the moratorium on collection of quality control disallowances for 1 year, until July 1, 1989, and requires the Secretary of Health and Human Services to submit recommendations for improving the quality control system by February 15, 1989.

The House bill provides that during the moratorium:

(1) The Secretary of Health and Human Services and the States shall continue to operate the AFDC quality control systems and to calculate error rates (maintaining the waiver request and review processes).

(2) The Departmental Grant Appeals Board shall continue to review disallowances (for fiscal year 1981 and thereafter) and to hear appeals, but collection of disallowances owed as a result of Board decisions "shall not occur."

The provision is effective on July 1, 1988.

Senate Amendment

No provision in H.R. 4333. (However, a similar extension of the moratorium to July 1, 1989, is included in H.R. 1720, the Family Support Act of 1988, P.L. 100-485.)

Conference Agreement

The conference agreement follows the Senate amendment (i.e., does not include the provision, as it is included in P.L. 100-485).

4. AFDC foster care independent living initiatives

Present Law

The Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272) authorized funds on an entitlement basis for State independent living programs, for fiscal years 1987 and 1988, to help

AFDC foster care children aged at least 16 make the transition to independence.

Eligible are children receiving assistance under the Title IV–E foster care program, which provides Federal aid for foster care maintenance payments. Title IV–E assistance is limited to those foster care children who would have been eligible for AFDC before they were removed from their home and placed in foster care.

The Secretary of Health and Human Services is required to submit a report on the program to Congress by July 1, 1988. States are required to submit reports on their programs to the Secretary not later than March 1988. The law provided $45 million in entitlement funds for the program in each of the two fiscal years (1987 and 1988), but States did not begin receiving funds until July 1987.

House Bill

The House bill extends authority for State independent living initiatives for foster care children for 1 year, through fiscal year 1989, with funding of $45 million.

The House bill also makes the following changes:

(1) Permits States to spend fiscal year 1987 carry-over funds in fiscal year 1989.

(2) Permits States to use program funds for services for two additional groups of children: any or all children in foster care who are at least age 16 (including those not receiving maintenance payments under Title IV–E) and, for up to 6 months after foster care payments or foster care ends, for children previously in foster care and whose care or payments ended on or after they attained age 16.

(3) Prohibits use of program funds for provision of room and board.

(4) Modifies the definition of case review under Title IV–E to clarify that the 18-month dispositional hearing must include a determination of the services needed to assist a child who has reached 16 make the transition from foster care to independent living.

(5) Requires each State to submit a report on the program by January 1, 1989 to the Secretary of HHS. Requires the Secretary to report to Congress on the program by March 1, 1989.

The authority for States to include non-AFDC foster care children in the independent living program and the prohibition on use of funds for room and board are effective on enactment. The remaining provisions are effective on October 1, 1988.

Senate Amendment

The Senate amendment is the same as the House bill, with the proviso that the funds have been appropriated. (Appropriations have been enacted for fiscal year 1989.)

Conference Agreement

The conference agreement follows the House bill, modified to require States to submit a report to the Secretary by February 1, 1989 rather than January 1, 1989.

C. Provision Regarding Report of National Commission on Children: Delay in Commission's Reporting Date

Present Law

The National Commission on Children, authorized under the Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203), is required to study and issue a final report by March 30, 1989 (and an interim report on September 30, 1988) with recommendations regarding health of children, social and support services for children and their parents, education, income security, and tax policy. The Commission is composed of 36 members, with 12 members each appointed by the President, the President pro tempore of the Senate, and the Speaker of the House. No fiscal year 1988 funds were appropriated for the Commission.

House Bill

No provision.

Senate Amendment

Because of the delay in funding for the Commission, the Senate amendment postpones the reporting dates for 1 year. Thus, the interim report would be due September 30, 1989, and the final report would be due March 31, 1990.

Conference Agreement

The conference agreement follows the Senate amendment, modified to require an interim report by March 31, 1990, and a final report by September 30, 1990.

D. Unemployment Compensation Provisions

1. Due dates for self-employment demonstration projects for unemployment compensation beneficiaries

Present Law

The Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203) authorized demonstration projects in three States to make available "self-employment allowances" that unemployment compensation claimants could use to set up a business. The allowances are equal in amount and duration to the participant's regular or extended unemployment compensation benefits; but participants are not subject to the usual requirement that they be available to work for another employer.

Current law requires two reports to Congress on these projects. An interim report is due no later than 2 years after the date of enactment (December 21, 1987), and a final report is due no later than 4 years after enactment.

House Bill

The House bill extends the due dates for reports on the projects. It requires the interim report to be submitted no later than 3 years after the date of enactment of P.L. 100-203 (i.e., by December 21, 1990); the final report, no later than 6 years after enactment of P.L. 100-203 (i.e., by December 21, 1993).

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Exemption of certain religious schools from Federal unemployment tax

Present Law

Section 3304(a)(6)(A) of the Federal Unemployment Tax Act (FUTA) requires States to cover under their unemployment compensation law certain nonprofit organizations. There are two exceptions from this required coverage, for services performed in the employ of: (1) a church, or convention, or association of churches; or (2) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled or principally supported by a church or convention or association of churches.

House Bill

No provision.

Senate Amendment

The provision amends the Internal Revenue Code to provide another exception from mandatory participation for service performed in the employ of an elementary or secondary school which meets certain requirements. To qualify for such exemption, the elementary or secondary school must be: (1) operated primarily for religious purposes, (2) described in section 501(c)(3), and (3) exempt from tax under section 501(a). The provision applies to services performed after December 31, 1988.

Conference Agreement

The conference agreement follows the House bill (i.e., no provision).

E. Medicare and Medicaid Amendments

1. Medicare provisions

Present Law

Title XVIII of the Social Security Act is the basic statutory authority for the Medicare program.

Title XVIII has recently been amended by provision of the Omnibus Budget Reconciliation Act of 1986 (OBRA 86), the Omnibus Budget Reconciliation Act of 1987 (OBRA 87), and the Medicare Catastrophic Coverage Act of 1988.

House Bill

No provision.

Senate Amendment

The Senate amendment contains several minor and technical amendments to the authority for the Medicare program.

Provisions Relating to Part A of Medicare

(a) The provision of the Medicare Catastrophic Coverage Act of 1988 regarding payment for hospitals exempt from the prospective payment system would be clarified.

(b) The provision of OBRA 87 regarding revision of standards for including a rural county in an urban area would be amended.

(c) The provision of the Medicare Catastrophic Coverage Act of 1988 regarding demonstration projects with respect to chronic ventilator-dependent units in hospitals would be amended to clarify that the Secretary is required to conduct at least five demonstration projects for at least three years each.

(d) The provision of OBRA 87 regarding personnel policy for Prospective Payment Assessment Commission employees would be amended to clarify that the provision of OBRA 87 is effective only for employees hired on or after December 22, 1987. Employees hired before that date could make a one-time election to be covered by the OBRA 87 policy or by policies previously in effect.

Provisions Relating to Parts A and B of Medicare

(a) Any HOM with increased costs due to the recent clarification of the benefit eligibility criteria for extended care would be allowed to submit a revised adjusted community rate for 1988.

(b) The provision of OBRA 86 regarding a program of research on patient outcomes would be amended to increase the authorization for fiscal year 1989 to $10 million and to provide an authorization of $20 million for fiscal year 1990 and of $30 million for fiscal year 1991.

(c) The provision of OBRA 87 regarding rural health policy would be amended to require a grant program on rural health, to authorize $3 million per year for each of fiscal years 1989, 1990, and 1991, and to create a national committee on rural health.

Provisions Relating to Part B of Medicare

(a) Clinical labs would be offered an option of being paid on a per mile or a flat fee basis for specimen collection costs.

(b) The provision of OBRA 86 providing budget neutrality for the fee schedule for certified registered nurse anesthetists would be clarified by specifying that the comparison between payment levels under the fee schedule and the 1986 reimbursement rules for payment of medical direction and CRNA services should take coinsurance into account on both sides of the equation.

(c) The provision of OBRA 87 providing coverage for certified nurse midwife services would be clarified to indicate that coverage is not limited to services provided during the maternity cycle.

(d) The provision of OBRA 87 providing coverage for services provided by psychologists in community mental health centers would be extended to services necessarily provided off-site as part of a treatment plan.

(e) The amendment would authorize payment for registered nurses providing services as surgical assistants subject to several conditions.

(f) Medicare policies regarding certification of physical therapy and occupational therapy providers would be amended.

(g) The moratorium on competitive bidding demonstrations for clinical lab services extended in OBRA 87 would be extended for an additional year.

(h) The Secretary would be authorized to pay for a medical escort or attendant on commercial air flights where such flights are covered as ambulance services.

Conference Agreement

The conference agreement follows the Senate amendment with an amendment as follows:

Provisions Relating to Part A of Medicare

(a) The authority for disproportionate share payments is extended to September 30, 1995.

(b) The provision of OBRA 87 regarding continuation of bad debt recognition is clarified.

With respect to criteria for what constitutes a reasonable bad debt collection effort, the conferees are concerned about recommendations made by the Inspector General of HHS subsequent to August 1, 1987, and actions which may be taken by the Secretary in response to those recommendations, regarding the bad debt collection policies followed by certain hospitals.

The Inspector General's recommendations, for example, recommendations concerning the extent of documentation required to demonstrate indigency and the provider's responsibility regarding a decision to use a collection agency for Medicare bad debt, appear to create requirements in addition to those in the Secretary's regulations, the decisions of the Provider Reimbursement Review Board, and relevant program manual and issuances.

The actions taken in response to the Inspector General's recommendations may have the effect of violating the prohibition on changes in policy if the Secretary's response results in the retroactive disallowance of bad debt payments claimed by the hospitals.

The conferees wish to clarify that the Congress intended that the actions of fiscal intermediaries occurring prior to August 1, 1987 to approve explicitly hospital's bad debt collection practices, to the extent such action by the fiscal intermediary was consistent with the regulations, PRRB decisions, or program manuals and issuances, are to be considered an integral part of the policy in effect on that date, and thus not subject to change.

However, the conferees do not intend to preclude the Secretary from disallowing bad debt payments based on regulations, PRRB decisions, manuals, and issuance is in effect prior to August 1, 1987.

(c) The provision of OBRA 87 regarding revision of standards for including a rural county in an urban area is amended to require that if the application of the new standards results in a reduction in the wage index for an urban area, the Secretary shall compute wage indices separately for the original urban counties and for the rural counties added as a result of the provision.

If the application of the OBRA 87 provision causes a reduction in the wage index for rural areas, the Secretary shall compute the wage index for the affected rural areas as if the OBRA 87 provision had not been enacted. The amendment applies to discharges occurrring on or after October 1, 1989 and before October 1, 1991.

The conferees recognize that certain area hospital wage indices for fiscal year 1989 will be reduced as a result of the OBRA 87 provision. The conferees also recognize, however, the administrative difficulty of requiring that the Secretary implement the amendment described above in fiscal year 1989. For this reason, the amendment requires that the Secretary report to Congress within 60 days on administrative and legislative alternatives that insure that payments in fiscal year 1989 to hospitals in urban and rural areas where wage indices were adversely affected by OBRA 87 are not less than they would have been without the OBRA 87 provision.

The conferees intend that the Secretary will develop and report on approaches for fiscal year 1989 that use existing administrative authority (such as the authority under section 1886(d)(5)(c)(iii) or legislative approaches. The conferees expect that the Secretary will focus on approaches that can be implemented as early as possible in fiscal year 1989 and are consistent with the intent of the conference agreement for fiscal years 1990 and 1991.

The conferees expect that the Secretary's report will include information on the impact of the alternatives on providers and on aggregate Medicare costs as well as data on the number of discharges and changes in payment to hospitals affected (positively and negatively) by the enactment of the OBRA 87 provision.

The conferees direct that the Secretary, in developing alternatives, consider particularly the special circumstances of hospitals located in redesignated counties for which a separate wage area is created as a result of the enactment of this provision and for which the resulting wage index is well below the statewide rural wage index. Hospital wages in some redesignated counties are as little as eighty percent of statewide rural wages. The conferees expect that the Secretary will develop alternatives that will minimize the effect of this provision on payment to these hospitals.

ProPAC is directed to study and report to the Congress within nine months of enactment on methodologies to adjust payments to hospitals affected by the OBRA 87 provision in fiscal year 1989.

(d) The provision of the Medicare Catastrophic Coverage Act of 1988 regarding demonstration projects with respect to chronic ventilator-dependent units in hospitals is amended to clarity that the Secretary is required to conduct at least five demonstration projects for at least three years each.

(e) The provisions of OBRA 87 regarding personnel policy for commission employees is amended to clarify that with respect to the Prospective Payment Assessment Commission, the provision of OBRA 87 is effective only for employees hired on or after December 22, 1987. Personnel hired before this date would have the option to elect to continue under previous personnel policies under a one-time election made within 60 days after enactment.

Provisions Relating to Parts A and B of Medicare

(a) The Secretary is required to establish graduate nursing education demonstration programs in five hospitals, under which the reasonable costs of education under the program will be allowable costs under Medicare. The Secretary is also required to establish one joint undergraduate nursing education program and to include reasonable costs of education under the program as allowable costs under Medicare. These costs would include salaries, supervision, and classroom costs. The conferees note that the provision should not be construed as affecting generally the proper treatment of these expenses under current law.

(b) The provision of OBRA 87 regarding assignment of members of HIP Health Maintenance Organization and treatment of Michigan Blue Care HMO Network under 50 percent rule are repealed.

(c) The authorization of appropriations for a program of research on patient outcomes of selected medical treatments and surgical procedures is increased to $10 million for fiscal year 1989, and authorizations are provided in the amount of $20 million for fiscal year 1990 and $30 million for fiscal year 1991.

(d) The reporting deadline for the United States Bipartisan Commission on Comprehensive Health Care is extended until six months after funds are appropriated for the Commission.

Provisions Relating to Part B of Medicare

(a) The conference agreement includes the Senate provision regarding payment for specimen collection fees with an amendment.

The Secretary would be required to provide for payment of specimen collection charges for certain labs on a per mile basis. The Secretary would also be required to submit a report to Congress by May 1, 1989 concerning reimbursement of specimen collection fees.

(b) The conference agreement includes the Senate amendment regarding the fee schedule for services provided by certified registered nurse anesthetists.

The amendment clarifies the budget neutrality provision by specifying that the comparison between payment levels under the fee schedule and the 1986 reimbursement rules for payment of medical direction and CRNA services should take coinsurance into account on both sides of the equation.

(c) The conference agreement includes the Senate amendment with modifications. Rules regarding coverage of pyschologists services provided in a community mental health center would be clarified to specify that such services would also be covered if necessarily provided off-site due to physical or mental impairment or similar reason.

(d) The conference agreement includes the Senate amendment regarding Medicare certification of physical therapy and occupational therapy providers.

(e) An addition would be made to the list of statutory responsibilities for the Physician Payment Review Commission. The Commission would be required to make recommendations for moderating the rate of increase in total Part B payment per capita and in the use of services under Medicare B in its annual report to Congress.

(f) The conference agreement includes the Senate amendment which extends the current moratorium on competitive bidding demonstrations for clinical lab services for an additional year.

(g) The conference agreement includes the Senate provision regarding payment for medical escort or attendant services with modifications.

The Secretary would be authorized to pay for such services on commercial air flights where such flights are covered as ambulance services under regulations currently in effect. This authorization would be in effect for a five-year period.

2. Medicaid provisions

a. Delay in issuance of final regulations concerning the use of voluntary contributions and provider-paid taxes by States to receive Federal matching funds

Present Law

The Medicaid program is a Federal-State program under which Federal funds are available to match State expenditures to purchase specified medical services on behalf of eligible individuals. Current regulations allow States to use as State expenditures for purposes of receiving Federal matching payments funds donated from private sources that are transferred to the State Medicaid agency, are under the agency's administrative control, and do not revert to the donor's facility or use unless the donor is a non-profit organization and the Medicaid agency, of its own volition decides to use the donor's facility. Some States also use funds that are generated from taxes on health care providers to draw Federal matching funds.

In the President's proposed budget for FY 1989, the Administration indicated that it would issue regulations to limit the use of donated funds to draw down Federal matching payments. The regulations have not yet been published.

House Bill

No provision.

Senate Amendment

Prohibits the Secretary of HHS from issuing final regulations that change the policy governing the use of donated funds or the use of revenues generated from provider taxes until after February 15, 1989. Proposed regulations could be published before that date.

Conference Agreement

The conference agreement follows the Senate amendment with a modification. The moratorium would extend until May 1, 1989.

Effective Date

Date of enactment.

b. Medicaid long-term care waiver program

Present Law

Section 1915(d) of the Social Security Act provides States an option to receive Federal Medicaid funding for nursing facility and home and community-based services for eligible elderly, subject to an aggregate limit. The limit is currently tied to the State's expenditures for such services during a base year, adjusted to take into account growth in the elderly population and increases in the cost of services, subject to a limit of 7 percent. However, the base year amount is not adjusted to take into account new mandated services or program expansions, such as the spousal impoverishment protections enacted in the Medicare Catastrophic Coverage Act of 1988.

House Bill

No provision.

Senate Amendment

Provides that the base year amounts would be adjusted to take into account new services and program expansions mandated by Federal law, effective with respect to State expenditures beginning in waiver year 1989.

Conference Agreement

The conference agreement follows the Senate amendment with technical modifications. Federal laws enacted after December 22, 1987, which increase aggregate Medicaid spending for either nursing facility services or home and community-based services would, at the request of the State and in close consultation with the State, be factored into the Secretary's determination of the aggregate limit for a particular waiver year or years.

The conference agreement also clarifies that, in calculating the aggregate limit for a particular waiver year, the Secretary is to apply the 7 percent adjustment to the number of years rounded to the nearest quarter of a year beginning after the base year and ending at the end of the waiver year. The following is an example of such a calculation where Year 1 is the base year, Year 3 is the first year the waiver is implemented and 7 percent is the lesser growth rate:

Year	*Expenditures*
1	$ 10,000,000
2	10,000,000
3	11,449,000
4	12,250,000
5	13,107,000

Effective Date

Waiver years beginning during or after FY 1989.

c. Extension of time period for submission of correction and reduction plans for certain intermediate care facilities for the mentally retarded

Present Law

Section 9516 of the Consolidated Omnibus Budget Reconciliation Act of 1985 allows an intermediate care facility for the mentally retarded (ICF/MR) that is found by the Secretary of Health and Human Services to have substantial deficiencies that do not pose an immediate threat to the health or safety of residents under the Medicaid program to submit a 6-month plan of correction or a 36-month plan of reduction as an alternative to decertification. The Department of Health and Human Services did not issue regulations implementing the section until January 25, 1988. The provision is scheduled to sunset on April 6, 1989. The final regulations do not allow the use of the plan of reduction in the case of a facility that was subject to decertification because of failure to provide active treatment.

House Bill

No provision.

Senate Amendment

Provides that the option to submit a plan of correction or reduction would be available in any case where there was no immediate threat to the health or safety of the residents, including failure to provide active treatment. However, active treatment would have to be provided for residents who remain in the facility during the period covered by the plan of reduction. The sunset date would be extended to January 25, 1991.

The provision is effective on the date of enactment. It applies to any proceeding where there has not yet been a final determination by the Secretary of HHS as of the enactment of this Act.

Conference Agreement

The conference agreement follows the Senate amendment with a modification that the sunset date would be extended to January 1, 1990.

Effective Date

Date of enactment. Applies to any proceeding where there has not yet been a final determination by the Secretary of HHS as of the date of enactment of this Act.

d. Nursing facility decertification hearing procedures

Present Law

Section 1910 of the Social Security Act provides that a nursing facility that is a party to a decertification proceeding based on a Federal look-behind review may continue to participate in the Medicaid program while a hearing on the issue is pending. The Department of Health and Human Services has taken the position that evidence of compliance based on a later Federal or State survey may not be admitted at such hearing. Thus, a facility maybe terminated on the basis of noncompliance that has subsequently been corrected.

House Bill

No provision.

Senate Amendment

Provides that in a decertification proceeding, nursing facilities would be allowed to submit evidence of correction of deficiencies based on Federal or State surveys conducted after the initial finding of noncompliance. This provision would not apply in the case of intermediate sanctions. While the amendment allows the results of a subsequent survey to be admitted as evidence, such evidence does not preclude a decertification finding. The Administrative Law Judge would also take into account the facility's record of noncompliance and the extent and likely duration of the compliance exhibited in such subsequent survey.

Conference Agreement

The conference agreement does not include the Senate amendment.

e. Sense of the Senate urging Congress to act on Medicaid reform for people with disabilities

Present Law

No provision.

House Bill

No provision.

Senate Amendment

The Senate amendment includes a provision expressing the sense of the Senate with regard to Medicaid reform for people with disabilities:

(a) *Findings.*—The Senate finds that—

(1) the needs of people with disabilities are not adequately met in the Nation's existing health care system;

(2) there is no well-designed system of services for individuals needing long-term support with the except of limited services available through Medicaid;

(3) such services are still rooted in the medical model;

(4) the Nation's understanding of the needs and capabilities of people with disabilities has progressed and it has become clear that traditional medically oriented services provided through Medicaid are frequently inadequate and inappropriate;

(5) all people, regardless of disability, should have the opportunity to live, work, and pursue recreational activities in their communities;

(6) the Medicaid program should be changed from one that demand dependency to one that seeks to encourage personal growth and is tailored to the needs of each individual;

(7) the Congress should ensure the availability of a wide range of services and support for people with disabilities and the families of such people in a variety of residential settings;

(8) such services should be designed to meet the unique needs of each person rather than requiring an individual to "fit into" a service system or residential placement;

(9) it is time for Congresss to consider seriously true reform of Medicaid services for people with disabilities;

(10) this issue has been the subject of serious debate in the Congress for the last 5 years and has been the subject of 4 hearings in the Committee on Finance of the Senate; and

(11) the Medicaid Home and Community Quality Services Act, S. 1673, has been introduced in the Senate to address the need for reform and has been cosponsored by 48 members of the Senate.

(b) *Sense of the Senate.*—It is the Sense of the Senate that—

(1) early in the 101st Congress Medicaid reform should be undertaken;

(2) such reform should ensure that services will be provided in a wide range of residential setting from in-home support to institution based care; and that independence, productivity and community integration should be our national goal for people with disabilities.

Conference Agreement

The Senate amendment expressed the sense of the Senate and was duly passed by the Senate, and it is not included in the conference agreement.

The conference agreement clarifies that individuals who, as of January 1, 1989, will be mandatorily eligible for coverage of their Medicare cost-sharing (qualified Medicare beneficiaries) are individuals who are entitled to Medicare, whose income meets specified standards, and whose resources do not exceed twice the amount allowed under the SSI program, whether or not they are otherwise eligible for Medicaid.

The conference agreement provides that, in calculating an optional premium for the second six months of transitional Medicaid benefits for the families who leave cash assistance due to earnings, a State must deduct the average monthly costs for necessary child care from gross monthly earnings.

The conference agreement clarifies that, in the case of a 1915(c) home and community-based services waiver that applies to individuals with a particular illness or condition, such as physically disabled individuals (who are at risk of institutional care), the Secretary must allow the State to determine the average per capita expenditure that would have been made in a fiscal year for those individuals separately from the expenditures for other individuals, whether or not those individuals are institutionalized prior to entering the waiver.

TRADE PROVISIONS

A. Iraqi Trade Sanctions

Present Law

No provision.

House Bill

The House bill contains no provision. However, the House passed H.R. 5337, a bill to impose sanctions against Iraq. The title of the bill is the "Sanctions Against Iraq Chemical Weapons Use Act". It states Congressional findings concerning the use of chemical weapons by the Government of Iraq against the Kurdish people and states that Iraq's use of such weapons is a gross violation of international law. The bill imposes certain immediate sanctions against Iraq, effective upon the date of enactment—a ban on exports and licenses for exports of certain munitions, items on the control list established pursuant to the Export Administration Act, and any chemical which the President determines may be used primarily in the production of chemical weapons.

H.R. 5337 also requires the President to impose "appropriate additional sanctions against Iraq" unless he certifies that the Government of Iraq is not using chemical weapons and has obtained reliable assurances that it will not do so in the future. The President is provided discretionary authority to impose the following additional sanctions: (1) prohibit or restrict imports of oil, oil products, or any other article grown, produced, or manufactured in Iraq; (2) prohibit or restrict the export of agricultural commodities and products and other goods and technology; (3) deny credits, credit guarantees, and other assistance; (4) oppose any loan or financial or technical assistance to Iraq by international financial institutions; (5) downgrade or suspend diplomatic relations between the United States and Iraq. The President must report to Congress periodically on the actions taken.

Contract sanctity for export controls imposed by H.R. 5337 is provided for contracts signed before September 15, 1988. For additional sanctions imposed by the President, contracts or agreements entered into before the President indicates his intention to impose sanctions (through notification of Congress or publication of a Federal Register notice) may not be prohibited or curtailed.

H.R. 5337 authorizes the President to waive the additional sanctions subject to the same certification requirement relating to Iraqi use of chemical weapons described above. It also contains provisions calling for certain multilateral actions; commending the Government of Turkey for accepting Kurdish refugees; and urging Presidential review of certain exports valued at over $50 million.

The authorities of H.R. 5337, and any sanctions imposed under it, cease to have effect after June 30, 1991.

Senate Amendment

The Senate amendment is similar to H.R. 5337, but with certain modifications and additions. It imposes immediate sanctions, but adds an additional up-front sanction—a requirement that the United States oppose any loan or financial or technical assistance to Iraq by international financial institutions. (This sanction is a discretionary sanction in H.R. 5337.) It adds that the purpose of the amendment is to mandate U.S. sanctions against Iraq due to its use of chemical weapons in violation of international law.

Like H.R. 5337, the Senate amendment requires that the President impose appropriate additional sanctions (subject to the same waiver authority) but requires that he do so by December 31, 1988. In addition, the Senate amendment requires that the President, in imposing such additional sanctions, select one or more of the sanctions authorized in the amendment. The authorized sanctions, which are similar to the sanctions in H.R. 5337, are: (1) deny credits or credit guarantees through the Export-Import Bank; (2) prohibit or restrict the importation of one or more kinds of articles (which may include petroleum or any petroleum product) that are the growth, product, or manufacture of Iraq; (3) prohibit or substantially restrict exports to Iraq of goods and technology (excluding agricultural commodities and products); (4) use the President's constitutional authorities to downgrade or suspend diplomatic relations between the United States and Iraq.

The Senate amendment adds a requirement that by December 31, 1988, the President submit to Congress an assessment of whether the Government of Iraq, is respecting internationally recognized human rights, in particular the rights of the Kurdish minority in Iraq. The assessment is to be accompanied by a report containing detailed information about various aspects of Iraq's treatment of the Kurdish minority and steps which the United States has taken to promote Iraq's respect of internationally recognized human rights and to discourage practices which violate such rights. Other provisions of the Senate amendment are identical to H.R. 5337.

Conference Agreement

The conference agreement contains no provision.

B. Other Trade Provisions

1. Trade technicals; certain tariff schedules

Present Law

The Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418), enacted on August 23, 1988, created new trade law authorities and amended many of the trade, tariff, and customs laws.

House Bill

No provision.

Senate Amendment

Section 800V of the Senate amendment contains 17 amendments of a strictly technical drafting nature to Title I of the Omnibus Trade and Competitiveness Act of 1988 or to various trade laws amended by Title I of that Act. These amendments correct errors concerning subsection, paragraph, and other designations, cross-references, punctuation, and rates of duty. The amendments would be applied on date of enactment as if they took effect on August 23, 1988 (date of enactment of P.L. 100-418).

Conference Agreement

The conference agreement follows the Senate amendment with amendments (1) to make four additional technical amendments to the trade laws of a similar nature to the Senate amendment; and (2) to extend the following expiring and expired duty suspensions as found in the Appendix to the Tariff Schedules of the United States, Part 1-B: TSUS items 903.29, 906.30, 906.32, 906.38, 906.51, 906.53, 906.54, 906.99, 907.00, 907.03, 907.04, 907.06, 907.08, 907.16, 907.18, 907.22, 907.25, 907.42, 907.51, 907.65, 907.66, 907.68, 907.69, 907.76, 910.00, 911.50, and 912.13.

2. Limitation on CBI ethanol imports

Present Law

The Omnibus Trade and Competitiveness Act of 1988 permits five companies to import 20 million gallons each of ethanol that does not meet the rules of origin of the Caribbean Basin Economic Recovery Act, as amended, in that the ethanol dehydrated in those plants is not fermented from vegetable matter grown in the region at plants located in the region.

House Bill

No provision.

Senate Amendment

This Trade Act provision would be barred after enactment of this bill until the Secretaries of Agriculture, Energy, and the Treasury, acting jointly, certify that the domestic ethanol industry is not fully meeting domestic demand for ethyl alcohol and that imported ethanol is necessary to maintain adequate supplies for consumers.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the House bill (i.e., no provision).

3. Foreign trade zones

Present Law

Section 3 of the Foreign Trade Zones Act, 19 U.S.C. 81(c), provides that when two or more products result from the manipulation or manufacture of merchandise in a foreign trade zone, the liquidated duties or taxes levied on those products are to be distributed according to each product's relative value at the time of separation.

House Bill

No provision.

Senate Amendment

Amends the Foreign Trade Zones Act to define the time of separation to be the entire manufacturing period; to define the price of the products, for purposes of computing relative values, as the average per unit value of each product for the manufacturing period; and, with regard to feedstocks for petroleum manufacturing, definition and attribution to products may be either in accordance with Industry Standards of Potential Production on a Practical Operating Basis or any other inventory control method approved by the Secretary of the Treasury.

The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

4. Study of U.S.-Japan trade and technology

Present Law

No provision.

House Bill

No provision.

Senate Amendment

The Senate amendment requires the Secretaries of Treasury and State and the U.S. Trade Representative jointly to conduct a study on possible frameworks for enhanced cooperation between the United States and Japan in the form of economic and security arrangements between the two countries. The final report on the study is to be submitted to the President and various Congressional committees by July 1, 1989, with an interim report by March 1, 1989. The amendment specifies numerous issues for consideration—e.g., tariffs, quotas, and other traditional subjects of a free trade area agreement; monetary and fiscal policies; anticompetitive practices and enforcement of antitrust laws. It establishes certain conditions for any frameworks negotiated—e.g., that they address mutual defense and sharing of the burden of defense; that they be consistent with the General Agreement on Tariffs and Trade. It also sets forth consultation requirements with public and private sector representatives of the United States and Japan.

Conference Agreement

The conference agreement follows the House bill (i.e., no provision).

5. GAO study on the Small Business Innovation Research Program

Present Law

Subsection (a) of section 6 of the Small Business Innovation Development Act of 1982 (15 U.S.C. 638, note) requires the Comptroller General, no later than December 31, 1988, to transmit to the appropriate committees of the House and Senate a report evaluating the effectiveness of certain phases of the Small Business Innovation Research (SBIR) Program. Section 8008 of the Omnibus Trade and Competitiveness Act of 1988 adds a requirement that the report by the Comptroller General also include recommendations concerning four specific potential changes to the SBIR Program.

House Bill

No provision.

Senate Amendment

Section 734 of the Senate amendment extends the due date for completion of the GAO report until July 1, 1989. The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with a technical correction so that the extension applies only to the four additional issues mandated by the Omnibus Trade and Competitiveness Act of 1988.

MANASSAS NATIONAL BATTLEFIELD PARK AMENDMENTS

Present Law

Manassas National Battlefield Park (the Park), designated in 1940 in Prince William County, Virginia, incorporates the battlefield where two significant Civil War battles were fought—First Manassas and Second Manassas. However, much of the battlefield of Second Manassas, including Stuart's Hill (location of Confederate General Robert E. Lee's headquarters and part of the William Center Tract immediately adjacent to the Park), has not been acquired as part of the Park. No major development occurred on the area, until a recent proposal was approved by the Prince William County Board of Supervisors to construct a mixed residential/nonresidential development on the William Center Tract. The proposed development would include a 1.2 million square foot shopping mall, major office space, and residential area.

House Bill

No provision in H.R. 4333. However, on August 20, 1988, the House passed a separate bill (H.R. 4526) requiring the acquisition of the approximately 600 acres adjacent to the Park and adding the area to the Manassas National Battlefield Park by legislative taking. H.R. 4526 also directs the Secretary of the Interior to conduct a study on the relocation of the roads in, and in the vicinity of, the Park; $30,000,000 is authorized for the study and the relocation of such roads.

Senate Amendment

The Senate amendment requires immediate acquisition of the area adjacent to the Manassas National Battlefield Park (south of U.S. Route 29, north of Interstate Route 66, east of Route 705, and west of Route 622), to be added to the Park by legislative taking. The United States is to pay just compensation to the owners of such property, and such payment is to be in the amount of the agreed negotiated value of the property or the valuation of the property awarded by judgment. The payment is to be made from the permanent judgment appropriation ("Claims and Judgments Fund") established under 31 U.S.C. 1304. (Other than this clarifying provision concerning the permanent judgment appropriation, the Senate amendment is the same as H.R. 4526 as passed by the House.)

The Secretary of the Interior is to work with the State and local governments to achieve scenic preservation of views from within the Park through zoning and other means the parties determine feasible.

The Secretary, in consultation with the Federal Highway Administration and State and local governments, is to conduct a study regarding the relocation of highways (known as Routes 29 and 234) in, and in the vicinity of, the Manassas National Battlefield Park. The study is to be completed within one year after the enactment of this Act. Appropriations of up to $30,000,000 are authorized for the study and the Federal share of the costs of relocating such highways. State and local governments are to provide 25 percent of the cost of the highway relocation from non-Federal sources.

The provision is effective on the date of enactment.

(The Senate amendment is the same as H.R. 4526 as reported on September 20, 1988, by the Senate Committee on Energy and Natural Resources, S. Rept. 100-520.)

Conference Agreement

The conference agreement follows the Senate amendment.

DAN ROSTENKOWSKI,
SAM GIBBONS,
J.J. PICKLE,
CHARLES B. RANGEL,
PETE STARK,
BILL ARCHER,
GUY VANDER JAGT,
Managers on the Part of the House.

LLOYD BENTSEN,
SPARK MATSUNAGA,
DANIEL PATRICK MOYNIHAN,
MAX BAUCUS,
DAVID L. BOREN,
BOB DOLE,
Managers on the Part of the Senate.

○

NOTICE: IN LIEU OF A STAR PRINT, ERRATA ARE PRINTED TO INDICATE CORRECTIONS TO THE ORIGINAL REPORT

100TH CONGRESS *2d Session*	HOUSE OF REPRESENTATIVES	REPORT 100–1104

TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988

CONFERENCE REPORT

TO ACCOMPANY

H.R. 4333

Volume II of 2 Volumes

OCTOBER 21, 1988.—Ordered to be printed

ERRATA

Page V, Contents of Statement of Managers, after I. 1. insert the following:

2. Modification of distilled spirits flavors credit (sec. 703 of the Senate amendment) 128

Page 128, preceding J. "Other Revenue-Increase Provisions" insert the following:

2. Modification of distilled spirits flavors credit

Present Law

A credit is allowed against the distilled spirits tax for the alcohol content of taxable beverages derived from wine and/or flavor components. The flavors credit is equal to the distilled spirits tax ($12.50 per proof gallon).

House Bill

No provision.

89-860

H783-12

Senate Amendment

The use of the flavors credit is available only where the flavors remain in the distilled spirits beverage after completion of distillation.

The provision applies to distilled spirits removed after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

○